MULTILATERAL TRADE NEGOTIATIONS

HEARINGS

BEFORE THE

SUBCOMMITTEE ON INTERNATIONAL FINANCE

OF THE

COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS UNITED STATES SENATE

NINETY-SIXTH CONGRESS

FIRST SESSION

ON

THE IMPLICATIONS OF THE TOKYO ROUND AGREEMENTS ON U.S. EXPORTS

APRIL 4 AND 5, 1979

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WEDNESDAY, APRIL 4, 1979

U.S. SENATE,
COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS,
SUBCOMMITTEE ON INTERNATIONAL FINANCE,
Washington, D.C.

The subcommittee met at 10:20 a.m., in room 5302 of the Dirksen Senate Office Building, Senator Stevenson (chairman of the subcommittee) presiding.

Present: Senators Stevenson, Morgan, and Tsongas.

Senator STEVENSON. The subcommittee will come to order.

This morning we begin hearings on the implications of the Tokyo Round agreements for U.S. exports. Our first witness is Ambassador McDonald, Deputy Special Trade Representative.

I welcome you, sir. If you would like, I would be happy to enter your full statement in the record.

STATEMENT OF ALONZO L. McDONALD, DEPUTY SPECIAL REPRESENTATIVE FOR TRADE NEGOTIATIONS, WASHINGTON, D.C., ACCOMPANIED BY MICHAEL ROWNY

Mr. McDONALD. Thank you very much, Mr. Chairman. I will take less than 10 minutes, I hope, in covering the major points here from my statement that I would like to be sure are included for the benefit of your subcommittee.

It is a pleasure for me to have this opportunity to meet with this subcommittee to discuss the implications of the Tokyo Round agreements on U.S. exports. I am especially glad to be meeting with you at a time when we are in the final days of the negotiations in Geneva. As a matter of fact, I will be back in that city next week for what I hope will be the closeout sessions and signing of the completed package.

Some intensive negotiations will take place during these final days. In spite of that, I am reasonably confident that we will come to an overall understanding with our negotiating partners and that the package will be presented to the Congress shortly thereafter.

This subcommittee and the Congress in general are deeply interested, and rightfully so, in the implications of the Tokyo Round agreements for the U.S. economy. In my view, the implications are overwhelmingly positive. I believe that the Tokyo Round results are potentially the most significant development in international trade since the establishment of the GATT over 30 years ago. The United States can look forward to important benefits, both short and long term, including major new opportunities for export growth across a wide spectrum of our industrial and agricultural sectors.

Although still falling short of our needs, exports have been one of the more dynamic sectors of our economy over the past decade, a fact too little appreciated in these difficult times. Between 1970 and 1978 exports grew twice as fast as our overall economy, by some 230 percent compared to 114 percent growth in total GNP.

Between 1971 and 1976, while total manufacturing employment remained approximately level at 19 million, manufacturing jobs related to exports rose by 900,000 or by some 60 percent.

In other words, without the stimulus of exports during this decade we would have lost a very substantial number of manufacturing jobs in this country.

The Tokyo Round benefits, however, will not come automatically, and I need to underline this point.

They represent opportunities that we must work to realize. With adequate Government help and encouragement, it will be primarily up to individual entrepreneurs in large companies and small to take advantage of these opportunities.

At the same time it will be the responsibility of our Government to exercise our rights under these new trade agreements, and to point the way to create conditions to help American firms move aggressively in the export field.

In my view, it is essential that this country become more export-minded.

Our large trade deficits in recent years have had a number of negative effects. They have weakened the dollar; they have added to inflationary pressures; they have shaken confidence at home in our ability to compete, and I can assure you from my special vantage point as the head of our negotiating team in Geneva, they have affected the confidence of our trading partners in our ability as a nation to lead.

Yet, lead we must. Our experience at the negotiating table in Geneva underlines this obligation. In economic affairs, the world still looks to the United States to serve as the model for others to follow and by its policy initiatives to serve as a nucleus for positive action.

I am personally very appreciative of the important work undertaken by this subcommittee aimed at strengthening our national commitment to exports. The recommendations of this subcommittee are encouraging for those of us in the front lines of trade representation. Clearly, they merit careful attention and study, and I hope will help point the way for a major improvement in our trade approaches and performance. Effective measures on the export side of the trade equation and measures to reduce disincentives to exports must be an integral part of our overall trade policy.

It may be useful to give you a brief overview, Mr. Chairman and members of the subcommittee, of the Tokyo Round results and some indications on timing as well as our thoughts at this point on the new opportunities to be created by the agreements. I note your particular interest in the possible effects of the code on subsidies, and I would like to make some comments about that as well.

First of all, the results of the Tokyo Round package. The full package includes the following elements:

(1) a series of nontariff measure codes and agreements on how trade will be conducted in a series of key sectors;

(2) a substantial agricultural package;

(3) an important liberalizing step in industrial tariff reductions; and

(4) a framework of understanding to modernize and improve the operation of the international trading system through the GATT.

First, the keystone of the Tokyo Round is a series of precedent-setting solutions, we believe, in the form of codes of conduct in nontariff areas of domestic policy heretofore considered sacrosanct domains of individual governments. Increasingly we find that a number of these nontariff barriers are primary forces distorting trade flows to the detriment of U.S. exporters.

These areas include nonmilitary government purchasing, product standards, government subsidies, customs valuation, licensing and treatment of counterfeit goods.

In addition, agreements on aerospace, steel, meat and dairy will provide additional benefits to the United States.

To cite only one example, the gains in export markets that will accrue to the United States from the government procurement code will likely be regarded over time as one of the major successes of the Tokyo Round.

The potential gains are large even in the short term, and they lay a sound foundation for continuing progress in the future.

We will open up a market potential of over $20 billion for U.S. producers in markets where we have been systematically excluded in the past.

We anticipate that the code will increase U.S. exports in the next 3 to 5 years by between $1.3 and $2.3 billion annually and U.S. imports by only $350 millon or a net export gain of between $1 and $2 billion.

We also expect an estimated net gain in job opportunities based on this code of between 50,000 and 100,000.

These estimates are deliberately, we believe, on the conservative side. We prefer to outperform than to outpromise. A number of factors will likely work in our favor to increase the net benefits of this code over time. At the present time foreign government procurement markets are virtually closed to the United States, whereas our market, as you know, is relatively open.

While the United States applies a 6- to 12-percent preference margin in favor of domestic producers and a 50-percent preference for some DOD purchases, U.S. law requires open bidding procedures and information.

We believe that the movement toward more open and transparent procedures abroad as a result of the code will bring additional, as yet unquantifiable, benefits to this country.

Also, the U.S. share of imports in likely signatory countries is quite high and the United States is an efficient producer of many of the goods likely to be purchased by the government entities to be covered by the code in those countries.

In the customs valuation code we have simplified and made more uniform national valuation systems and have thus reduced the possibilities of manipulation.

While it would be difficult to assess the code in quantitative terms, I am confident that it will be a major factor in opening up foreign markets to U.S. exporters.

Turning again to product standards, the third one of the codes, we have established a framework which should significantly reduce the possibility that standards will be defined and applied in discriminatory ways to keep out American exports.

The dispute settlement mechanisms contained in the code will, for the first time, put in place agreed procedures for resolving controversies as to whether individual standards are legitimate attempts to protect public health, safety, and product quality or are simply subterfuges for trade restrictions.

The standards code is also very difficult to quantify, but STR has received complaints about foreign product standards whose annual total export value exceeds $10 billion. The enormous magnitude of the export value involved is an indication of the potential universe of direct benefits for the United States.

The code on subsidies is another major area of benefit for this country because, for the first time, it makes a concerted approach to some of the more inaccessible subsidy practices employed by foreign governments. At the same time, it does not seriously effect U.S. ability to adopt likely new programs to meet foreign competition. In fact, renewed emphasis on the importance of exports led President Carter to announce a first major step in his export promotion program last September.

The subsidies code contains tough new provisions setting out what governments cannot do in the subsidy field.

All governments are prohibited from direct export subsidies on industrial products. This applies to all existing export subsidy practices as well as prohibiting future export subsidy schemes.

Furthermore, governments will be forced for the first time to take into account new disciplines on domestic subsidies, a subject that previously has not been actively considered within the GATT.

Of particular importance to the United States, governments also agree that agricultural subsidies cannot be used to gain undue shares of third-country markets or to materially undercut prices. This was one of our top priorities during the course of the agricultural negotiations.

On the other hand, your negotiators have carefully made sure that the subsidies code does not affect the status of the DISC tax program. Eximbank activities are not restricted. We would not be prevented from passing legislation facilitating the formation of U.S. export trading companies.

In short, the code provides important new guarantees for us without jeopardizing our own important rights and thus constitutes one of the major Tokyo Round benefits to this country.

The agricultural component of the package will provide many benefits to U.S. exporters and related enterprises such as transportation, processing, distribution, and retailing.

Agricultural exports in 1978 amounted to $29.4 billion, more than four times as great as in 1968, and provided a positive contribution to our balance of payments of $14.6 billion.

That represents about one-fifth of all U.S. exports and accounts for over 1 million jobs, on and off the farm.

That impressive performance would have been even better in the absence of increasing protectionism in world agricultural markets.

The Tokyo Round, we believe, will mark a major step in our efforts to free up markets and to give the forces of supply and demand a chance to operate.

Also in the agricultural area, we received specific product concessions covering some $3.8 billion in U.S. agricultural exports (1976 basis) in all of our important markets. This figure is a rough estimate of what the concessions are worth in yesterday's values. They are already worth much more to us today, and the figures do not begin to indicate the potential worth of these concessions in the future.

The other major element of the negotiations, industrial tariff reductions, offers new opportunities in literally thousands of product areas. While the average overall depth of cut among major participants will likely be in the neighborhood of 30 to 35 percent, many deeper reductions have also been negotiated.

The overall impact of the Tokyo Round agreement should be examined from a number of aspects. With regard to the overall employment effects, studies thus far available tend to suggest that the impact of industrial tariff cuts, for example, would be negligible in view of the size of total U.S. employment (over 92 million at the end of 1977), and in light of the 8-year staging of tariff reductions.

I should say that to make sure we were avoiding any immediate disruptions that could have dire political, economic or social consequences, the staging of tariff reductions in the Tokyo Round has deliberately been paced over a longer period of time than any of our previous negotiating rounds.

All of these earlier studies that have indicated the impact of this round, particularly with respect to the favorable rate of employment for the U.S., should be regarded strictly as preliminary and indicative in character. They assumed an overall cut of about 50 percent or more.

As those very closely watching the negotiations from the Congress have seen, we have departed significantly from that, taking particular care to concern ourselves with those more sensitive areas and sensitive industries in our economy.

Also, one should note that the recent CBO study contains some helpful analyses.

It reflects clearly our original going-in position calling for a 50-percent tariff reduction.

I can assure you from a negotiator's perspective that report was particularly reassuring, since we have been modifying significantly our initial offer in line with some of the concerns pointed out in that report and those expressed by the private sector and by the Congress.

I think one final comment, an important caveat, must be inserted at this point regarding any attempt to quantify the results of the Tokyo Round, whether we refer to tariff reductions or to the effects of nontariff measure codes.

There are simply too many elements involved.

Based on my some 20 to 25 years' experience in the private sector prior to assuming this responsibility, I believe that the variables are too complex to come up with any definitive figures that I would consider to be authentic.

In addition, we should know that other factors such as tax incentives and the basic trading policies of governments, may be more important than what we have negotiated in this round in determining our overall opportunity.

Mr. Chairman, I think that covers my major points from the statement that I wanted to particularly point out at the beginning.

I would like to thank you again for this opportunity to appear, and I will be happy to deal with any questions that you or the members of the subcommittee may have.

[Complete statement follows:]

STATEMENT OF AMBASSADOR ALONZO L. MCDONALD, DEPUTY SPECIAL TRADE REPRESENTATIVE

Mr. Chairman and Members of the Subcommittee: It is a pleasure for me to have this opportunity to meet with this Subcommittee to discuss the implications of the Tokyo Round agreements on U.S. exports. I am especially glad to be meeting with you at a time when we are in the final days of the negotiations in Geneva. As a matter of fact, I will be back in that city next week for what I hope will be the close out sessions and signing of the completed package. Some intensive negotiations will take place during these final days, but I am reasonably confident that we will come to an overall understanding with our negotiating partners and that the package will be presented to the Congress shortly thereafter.

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Although still falling far short of our needs, exports have been one of the most dynamic sectors of our economy, a fact too little appreciated in these difficult times. Between 1970 and 1978 exports grew twice as fast as our overall economy, by 230 percent compared to 114 percent growth in total GNP. Between 1971 and 1976, while total manufacturing employment remained approximately level at 19 million, manufacturing jobs related to exports rose by 900,000 or by 60 percent. In other words, without the stimulus of exports, we would have lost a very substantial number of jobs in this country.

The Tokyo Round benefits, however, will not come automatically. They represent opportunities that we must work to realize. With adequate government help and encouragement, it will be primarily up to individual entrepreneurs in large companies and small to take advantage of them. At the same time it will be the responsibility of our government to exercise our rights under these new trade agreements, and to point the way, to create conditions to help American firms move aggessively in the export field.

In my view, it is essential that this country become more export-oriented. Out large trade deficits in recent years have had a number of negative effects. They have weakened the dollar; they have added to inflationary pressures; they have shaken confidence at home in our ability to compete and they have affected the confidence of our trading partners in our ability as a nation to lead. Yet, lead we must. Our experience at the negotiating table in Geneva underlines this obligation. In economic affairs, the world looks to the United States to serve as the model for others to follow and by its policy initiatives to serve as a nucleus for positive action.

I am personally very appreciative of the important work undertaken by this Subcommittee aimed at strengthening our national commitment to exports. The recommendations of this Subcommittee are encouraging for those of us in the front lines of trade representation. Thereby they merit careful attention and study, and I hope will help point the way for a major improvement in our trade approaches and performance. Effective measures on the export side of the trade equation and measures to reduce disincentives to exports must be an integral part of our overall trade policy.

It may be useful to give you a brief overview of the Tokyo Round results and some indications on timing as well as our thoughts at this point on the new opportunities to be created by the agreements. I note your particular interest in the possible effects of the code on subsidies, and I would like to make some comments about that as well.

The Tokyo Round package

The full package includes the following elements: (1) a series of nontariff measure codes and agreements on how trade will be conducted in a series of key sectors; (2) a substantial agricultural package; (3) an important liberalizing step in industrial tariff reductions; and (4) a framework of understanding to modernize and improve the operation of the international trading system through the GATT.

First, there is a series of precedent-setting solutions in the form of codes of conduct in nontariff areas of domestic policy heretofore considered sacrosanct domains of individual governments. Increasingly we find that a number of these nontariff barriers are primary forces distorting trade flows to the detriment of U.S. exporters. These areas include nonmilitary government purchasing, product standards, government subsidies, customs valuation, licensing and treatment of counterfeit goods. In addition, agreements on aerospace, steel, meat and dairy will provide additional benefits to the United States.

To cite one example, the grains in export markets that will accrue to the United States from the government procurement code will likely be regarded as one of the major successes of the Tokyo Round. The potential gains are large in the short-term, and they lay a sound foundation for continuing progress in the future. We will open up a market potential of over $20 billion for U.S. producers in markets where we have been systematically excluded in the past. We anticipate that the code will increase U.S. exports in the next three to five years by between $1.34 and $2.34 billion annually and U.S. imports by only $0.34 billion, or a net export gain of between $1 and $2 billion. We also expect an estimated net gain in job opportunities based on this code of between 50,000 and 100,000.

These estimates are deliberately on the conservative side. We prefer to outperform than to outpromise. A number of factors will likely work in our favor to increase the net benefits over time. At the present time foreign government procurement markets are virtually closed to the United States, whereas our market, as you know, is relatively open.

While the United States applies a 6 to 12 percent preference margin in favor of domestic producers and a 50 percent preference for some DOD purchases, U.S. law requires open bidding procedures and information. We believe that the movement toward more open and transparent procedures abroad as a result of the code will bring additional, as yet unquantifiable, benefits to this country. Also, the U.S. share of imports in likely signatory countries is quite high and the United States is an efficient producer of many of the goods likely to be purchased by the government entities to be covered by the code in those countries. Thus, we will be building on our good reputation in areas where we have demonstrated a continuing ability to compete. And one final observation, state interventionism is growing rather than decreasing overseas. Many of the production activities which we in the United States consider to be the proper domain of the private sector have tended to become state-owned or controlled activities in many of our trading partners. This represents a major gap between our economic systems. This is a serious problem for a free enterprise economy and one which goes far beyond the confines of this particular code. But regarding government procurement practices, to the extent that the code reduces discrimination against foreign sourcing of goods, we will have struck a solid blow for free enterprise.

In the customs valuation code we have simplified and made more uniform national valuation systems and have thus reduced the possibilities of manipulation. While it would be difficult to assess the code in quantitative terms, I am confident that it will be a major factor in opening up foreign markets to U.S. exporters. This is only partly suggested by the fact that STR has received complaints about foreign valuation practices covering a wide range of products with a total export value exceeding $1.2 billion of our exports per year. It is also reflected by the tenaciousness with which some of our major trading partners have tried to retain subjective valuation techniques. Aside from eliminating arbitrary foreign practices such as uplifts, the customs valuation code is also an insurance policy for the future. With the further reduction of tariffs in the Tokyo Round to the point where they are no longer prohibitive in most instances, the incentive to use artificial customs valuation procedures as protective devices would be increased in the absence of this new discipline.

In the case of product standards, we have established a framework which should significantly reduce the possibility that standards will be defined and applied in discriminatory ways to keep out American exports. The dispute settlement mechanisms contained in the code will, for the first time, put in place agreed procedures for resolving controversies as to whether individual standards are legitimate attempts to protect public health, safety and product quality or are subterfuges for trade restrictions.

The standards code is also very difficult to quantify, but STR has received complaints about foreign product standards whose annual total export value exceeds $10 billion. The enormous magnitude of the export value involved is an indication of the potential universe of direct benefits for the United States.

The code on subsidies is another major area of benefit for this country because, for the first time, it makes a concerted approach to some of the more inaccessible subsidy practices employed by foreign governments. At the same time, it does not seriously affect U.S. ability to adopt likely new programs to meet foreign competition. In fact, renewed emphasis on the importance of exports led President Carter to announce a final major step in his export promotion program last September.

The subsidies code contains tough new provisions setting out what governments cannot do in the subsidy field. All governments are prohibited from direct export subsidies on industrial products. This applies to all existing export subsidy practices as well as prohibiting future export subsidy schemes. Furthermore, governments will be forced for the first time to take into account new disciplines on domestic subsidies. Of particular importance to the United States, governments also agree that agricultural subsidies cannot be used to gain undue shares of third country markets or to materially undercut prices.

On the other hand, your negotiators have carefully made sure that the subsidies code does not affect the status of the DISC tax program. Ex-Im Bank activities are not restricted. We would not be prevented from passing legislation facilitating the formation of U.S. export trading companies. In short, the code provides important new guarantees for us without jeopardizing our own important rights and thus constitutes one of the major Tokyo Round benefits to this country.

The agricultural component of the package will provide many benefits to U.S. exporters and related enterprises such as transportation, processing, distribution and retailing. Agricultural exports in 1978 amounted to $29.4 billion, more than four times as great as in 1968, and provided a positive contribution to our balance of payments of $14.6 billion. That represents about one-fifth of all U.S. exports and accounts for over one million jobs, on and off the farm.

That impressive performance would have been even better in the absence of increasing protectionism in world agricultural markets. The Tokyo Round will mark a major step in our efforts to free up markets and to give the forces of supply and demand a chance to operate once again.

We received specific product concessions covering some $3.8 billion in U.S. agricultural exports (1976 basis) in all of our important markets. This figure is a rough estimate of what the concessions are worth in yesterday's values. They are already worth much more to us today, and the figures do not begin to indicate the potential worth of these concessions in the future. To illustrate, during the Dillion Round of trade negotiations in the early 1960's, the United States obtained a duty-free binding on soybeans from the European Community covering only $750 million in U.S. soybean exports. Today we export over $2.5 billion annually to the EC thanks to that concession. Our Tokyo Round beef concession from Japan alone should produce more than $125 million in annual export trade and that is only the beginning.

The other major element of the negotiations, industrial tariff reductions, offers new opportunities in literally thousands of product areas. While the average overall depth of cut among major participants will likely be in the neighborhood of 30 to 35 percent, many deeper reductions have also been negotiated.

Overall impact

The overall impact of the Tokyo Round agreement should be examined from a number of aspects. With regard to the overall employment effects, studies thus far available tend to suggest that the impact of industrial tariff cuts, for example, would be negligible in view of the size of total U.S. employment (over 92 million at the end of 1977), and in light of the eight-year staging of tariff reductions.

A number of studies several years ago addressed themselves to the impact of tariff cuts averaging between 45 and 60 percent. They showed gains of job opportunities in most cases. A Brookings study calculated that the new change would amount to a net increase of some 80,000 jobs. A study by Deardorff-Stern put the figure at a gain of 153,000 jobs. A Labor Department study projected a 41,000 job increase. A study by Baldwin suggested a net loss of 27,000 jobs.

All of these earlier studies should be regarded strictly as preliminary and indicative in character. They assumed a depth of cut of about 45 percent or more and a tariff-cutting formula of general application. The actual result will be closer to 30 percent, so that the employment effects will be somewhat smaller than suggested by the above figures, but we believe they should be favorable.

The recent CBO study contains some helpful analyses. It reflects clearly our original going-in position calling for a 50 percent tariff reduction. That report was particularly reassuring to us at the negotiating table since our initial offer has been modified significantly during the course of the negotiations to take into account the possible imbalances that report pointed out and the concerns expressed by the private sector and by Congress.

An important caveat must be inserted at this point regarding any attempt to quantify the results of the Tokyo Round, whether we refer to tariff reductions or to the effects of nontariff measure codes. First of all, the issues involved are far too complex to lend themselves to easy quantitative analysis. But more important, the Tokyo Round result cannot be isolated from many other elements affecting employment. Tax policies and government incentives for investment could have a far greater impact, to name just two factors. In short, the Tokyo Round will not by itself change the world, but it will make it more rewarding, fairer and more certain for those who are willing to make the effort.

Looked at from a slightly different angle, that of new export opportunities, the benefits from the negotiations should be spread throughout the economy. Our more dynamic, export-oriented industries with proven track records, such as machinery, chemicals, aircraft, computers, textile mill products and others will doubtlessly seize quickly the new opportunitie presented to them.

In those few cases where the impact may be less positive it is the responsibility of government, in my view, to improve domestic procedures and adjustment assistance programs to mitigate any negative effects. I am pleased that the Administration and the Congress are working together in this area as a part of the implementing legislation. Cutting the time for action on a subsidies complaint from 12 to four months, as we have proposed, for example, is an important contribution to a smooth adaptation to the change negotiated.

In examining the impact of the Tokyo Round in the short-term as opposed to the long-term we can distinguish two types of benefits. In the short run, we will detect a new atmosphere for doing business abroad. Without a positive Tokyo Round result, the future would be bleak indeed. Countries would be channeling their energies more at avoiding trade with one another than with facilitating and expanding commercial exchanges. We would enter a period of constant confrontation and the tedious lost man years of adjudication and conflict. At this time of shared responsibilities and common problems, the world simply cannot afford that type of trading environment. Nor can it afford to add to today's enormous economic uncertainties a complete shadow across the scene $1.3 trillion in annual international trade.

A successful Tokyo Round will do more in the short run and in the long term as well, to forestall protectionism than any other program I could imagine.

The result itself will not create any new long run structural problems, nor will it stop any structural changes now underway. At most it may slightly accelerate the ongoing process of change and rejuvenation that are essential elements of a competitive economy. I offer no apology for that. Innovation, dynamism and competition are the lifeblood of the American economy, but they do not thrive if entrepreneuerial energy and ambition are drained out of the system. Governments have repeatedly shown that they cannot reverse the underlying process of economic change, nor should they attempt to do so. Like it or not, the conditions of the 1960's are part of our national past; economic uncertainly will likely be the rule rather than the exception for the foreseeable future. A successful Tokyo Round can serve as a critical stabilizing factor in the years ahead.

Mr. Chairman, this concludes my statement. I would be pleased to answer any questions you or other members of the Subcommittee may have.

Senator STEVENSON. Thank you, Ambassador, your statement is encouraging and reassuring. The full statement will be entered into the record. I think you and Ambassador Strauss are to be commended for your work in these difficult negotiations. I hope we can carry it on here in the Congress.

I thank you also for delivering the Ambassador's response to my most recent letter, and in a moment, I will enter it in the record.

But as you point out, there are many factors involved. We have made the same point in the subcommittee report to which you referred at the opening of your statement. My concern is that the successful conclusion of these negotiations will reduce nontariff barriers. Tariff barriers are also coming down. And the competition will then shift to the export promotion side.

I think this is what you were getting at towards the end of your statement. Nations will still remain heavily dependent on imports including increasingly expensive imports of fuel and will continue to have every incentive to fight for the world's markets with everything that they have available to them. More and more countries are coming onstream, including LDC's, combining high technology, low resource and labor costs, and aggressive marketing.

Taiwan is now exporting television sets and steel to Japan. So, with our responsibility for exports and the concern about the shifting nature of the competition, we have been particularly concerned about the effect of these negotiations on export subsidies, and the risk that the export subsidies and other support for foreign competitors will continue, and ours will either be prohibited, or we will be prevented from adopting them in the first instance.

I wrote Ambassador Strauss concerning a rumor that I heard, which was that certain export subsidies might get grandfathered in foreign countries, but be prohibited for our own, and raised with him illustratively the case of trading companies, not that those are subsidies. But they might be.

He has now written, saying that the codes will not prevent the United States from authorizing the creation of trading companies which hopefully could then compete with the trading companies of other countries including the Japanese.

As I think you know, our subcommittee report recommends that the United States approve the creation of such companies in order to represent competing product lines and small industries as well as large in all parts of the world.

To do that, we must grant trading companies some tax exemptions, for example, deferral of taxes on foreign earned income until it is repatriated. We would like to go beyond that to grant them some special considerations for their startup cost, just to help them get started.

Do you think tax incentives for new trading companies in the United States would be prohibited?

Mr. McDONALD. I think that they will have to be carefully worked out, Mr. Chairman. But I believe most of the elements that you referred to can be accommodated within the range of the code.

As a matter of fact, in Geneva, we watched carefully the hearings conducted by this subcommittee as well as some of the other interested committees on the Hill, and I think you might be interested in some of the guidelines we used at the negotiation table in terms of trying to preserve for ourselves as much latitude as we thought would be reasonable.

If I may, sir, I will summarize some of those, because I think they would be of interest.

Senator STEVENSON. Please.

Mr. McDONALD. Here are some of the things that within the framework of our subsidies code, the way it is negotiated, we can do. I am not suggesting these are necessarily controlling factors, nor should they necessarily be done.

But what our concern was as negotiators was make sure the choice was ours and we have not preempted by our international commitments from doing what we felt domestically would be in our best interests.

But, for example, in the area of export credits and guarantees, these can be provided and these can certainly be expanded within the framework of the gentlemen's agreement within the OECD. We have nothing that would prohibit that agreement from either changing or increasing.

As a matter of fact, I think we are at complete liberty to determine what would be the appropriate level of export credits to give to our entities and that is one of the elements I know your subcommittee had been concerned with.

Senator STEVENSON. Let me interrupt, if I may, as you go along.

Mr. McDONALD. Please.

Senator STEVENSON. Does that statement refer to CCC credits for agricultural exports as well as exemption for nonagricultural exports?

Mr. McDONALD. Yes, it does, Mr. Chairman. Although, as I indicated, I believe, earlier to the committee, our review of competitive situations indicates within our CCC we may be even closer to providing an appropriate solution than we are on the industrial side, but that is still a question deserving your review.

Senator STEVENSON. But CCC will not be adversely affected?

Mr. McDONALD. That is true.

Senator STEVENSON. Thank you.

Mr. McDONALD. The second I might mention concerns export promotion activities. I think we are free to provide whatever reasonable help we think appropriate, administrative assistance to exporters, information on foreign market, information on bids, translation activities and the other normal support activities that we might think would be appropriate for the launching of new activities or for the encouragement of a broader base of American business to take a first step into the international area.

I might also say just in passing, this is a bit of a tangent from my direct response to your earlier question, one of the major elements we consider to be important in the whole series of codes deals with a higher level of certainty in terms of what the rules of the game are going to be.

In my earlier private enterprise experiences, one of the difficulties of embarking on an export program was the high risk and uncertainty related to that high risk. It is very hard to calculate. We are hopeful that some of the elements of those risks will be laced into a better framework of certainty that would be useful to us.

A third element in which we can take whatever actions we think are important, and one that is of great concern to you and members of the subcommittee, is in the relaxation of disincentives to exports. We know really of no limits that would be involved there. Those could involve such things as you mentioned in your committee report. We see no restrictions that would bother us domestically from proceeding in that direction in whichever way the Congress and the decisionmakers determine is appropriate.

Next is deferral of tax on earnings from sales operations based overseas to provide treatment equal to manufacturing operations abroad. Again, there is a differentiation between our and foreign practices. That would be another opportunity open to us if it appeared appropriate, without violating our international obligations.

Next we could refund many of the so-called indirect taxes that might be now existent in our economy or might later be considered.

Senator STEVENSON. Value added?

Mr. McDONALD. Exactly. One of the statements that, following consultations with members of the Finance Committee and others from the House who were visiting in Geneva that I particularly made at their request was that the United States reserved all its options to look at those without any obligation for compensation later on. Although legally they are permissible in the GATT, we consider they do have a distorting effect on trade. If we chose at some point in time to equalize that situation, whether for trade reasons or for other reasons, we would consider that that would be our just due. So our latitude is wide open on that score.

Further, any generalized incentives, Mr. Chairman, that are not specifically aimed for exports themselves, but really contribute to the dynamism, competitive stature, the strength of our industrial base, would be entirely permitted.

Such things as accelerated depreciation, incentives for new capital investment, tax or other incentives for productivity increases, incentives for research and development, another item touched on in your committee report. Consequently, we think that, again, our latitude is quite wide.

Finally, one should mention liberalized tax treatment for representatives of the U.S. firms resident overseas. One should note just in passing that our treatment in our tax situation of individuals residing abroad is considerably different from that of other countries who tend to tax on the basis of residence rather than on the point of citizenship.

Just as an illustration, our United Kingdom friends, for example, seek opportunities for overseas assignments, even of short duration, because their earnings while on those commercial endeavors are exempt from their domestic high rate.

Consequently, one of the things that I think the Congress is already doing and we would certainly want to make sure, is that we have a reasonable representation of the American ecomonic society in residence abroad. We have suffered some cutbacks in that area within the last few years as your subcommittee is well aware. We hope it has not moved below the danger point. But it is an issue of concern to those predominantly involved in exorting and international business.

The things we cannot do on the other side of the question, as I mentioned in my statement, Mr. Chairman, are to provide direct tax incentives for export efforts.

Senator STEVENSON. That will pick up——

Mr. McDONALD. Those are prohibited. We have made a special exemption, DISC. We felt we would have enough problems without undertaking that struggle.

The administration's position is quite clear on DISC. As a result of the negotiation, the United States is free to handle that ourselves. Its status has not been changed at all by the negotiation of the code.

Senator STEVENSON. You say there is a prohibition against these direct tax subsidies, if that is the right word, for the export sector, but not for DISC.

How do you do that? Is DISC just grandfathered in?

Mr. McDONALD. We in special notes to the code reserve the status of the DISC, as it is, by mutual agreement with our negotiating partners.

If we did not have the DISC at this point in time, under the normal provisions of the code and had we not in effect grandfathered it, it would be ineligible to be considered under our international agreements.

Senator STEVENSON. Could you enlarge upon what you said earlier about the procurement code, and with specific reference to Japan?

I was under the impression that our negotiations with respect to Japanese Government procurement had not been successful.

Mr. McDONALD. We have come right to the final line of a possible agreement, Mr. Chairman.

That may or may not take place at this point. We have insisted the Japanese include in their coverage their telecommunications systems.

Our telecommunications systems are generally open to their products, and they have known and realized quite an important inroad within the last 2 or 3 years. As in the normal course of events, our industry has been opened up more to outside competition.

Theirs has been traditionally closed to us. We said this was simply an imbalance we could not accept, and we would prefer to exclude Japan entirely from participation in the Government procurement code unless we can find an adequate solution to the coverage problem.

We are still working on that at the negotiating table, but at this point in time, we have broken off negotiations until they can reconsider their offer.

We think that we have an unfair balance as it presently stands.

We would prefer, therefore, to exclude Japan entirely from access to our Government procurement activities unless we can be assured that we have what we believe is an equal and fair opportunity on their side.

Senator STEVENSON. Wouldn't the Japanese Government procurement practices violate the new code on Government procurement?

Mr. McDONALD. They will, unless modified, Mr. Chairman. This is one reason that has been a very tough negotiation with the Japanese all along.

We have a question of changes in their procedures, we have questions of changes in their normal practices, we have questions of single-tendering practices that the Japanese have followed.

And then we have the last point dealing with the actual coverage itself. Even under the best conditions, Mr. Chairman, we would anticipate a difficult time entering that market. We certainly, therefore, cannot afford to make an arrangement in which we think we would start at an unfair advantage.

Senator STEVENSON. Now, it has been said and will be said that we are the good guys, we will comply with the spirit and the letter of these codes, but other countries will not. We don't have all of their export supports. We will be prevented from catching up.

They will continue to resort to every trick and device in the book to beat us in the world. Especially in the LDC's, the advanced LDC's, and consequently, we are going to lose out.

How do you reply to that complaint?

Mr. McDONALD. Mr. Chairman, I think that is a real threat. I think that does not have to happen.

Within the scope of the international negotiations, we can do something about it. It is the intention of our Government to do so.

We cannot handle that passively, however. It is going to take a much more active stance in our trade relationships than has been traditionally our practice.

From the negotiating perspective, let me mention one or two things that will assist us if we have the will to pursue our rights in the trade area.

One is an element included in the program of modernization of the GATT in the trading system dealing with dispute settlements.

We have a vastly improved and reinforced dispute settlement mechanism in which we can bring for objective view before a multilateral group, individual disputes and complaints that we might have.

This is a far more active processs than the GATT has even known. It was one that was negotiated long and hard against some resistance of a pretty intense kind, from countries who deal more in closed administrative procedures rather than open statutory processes similar to our own.

But we are pleased to say that we have instituted as a part of each of these nontariff measure codes, and also as a part of the improvements in the appeals to the GATT under articles 22 and 23, a much improved and accelerated dispute settlement mechanism.

For example, guaranteed right to an objective panel; a requirement for that panel to take a point of view; very limited time periods in which they must act so that the GATT does not become simply an infinite debating society in which disputes last for years and finally wear out simply by longevity of debate rather than resolution of the issue.

Consequently, we see the mechanism now being put in place for the United States and for others who are interested in preserving and insuring their rights to take a far more aggressive view.

As far as the LDC's are concerned, we are very pleased that literally within the last 48 hours, there appears to have been a formal agreement concerning the framework exercise, the framework of how the GATT will work, including substantial benefits for the LDC's and for the developed countries.

Quite a mutually balanced package, but one that we think will draw them into the disciplines of the international system to a far greater extent than before.

They will have a more open and direct stake in how the system goes. Again at the negotiating table, we have continually pointed out that an effective dispute management mechanism is even more to their advantage than ours. The opportunity for retaliation is not very great, but such a mechanism is a real weapon for the weak, as it is for us as a country, if we want to use it.

Consequently, they must be even more independent than the strong in terms of having a disciplined international system in which objective treatment can be given. I should make one other comment, Mr. Chairman.

That is that we are viewed by our overseas trading partners as moving in a very volatile pattern in trade matters. During rounds such as the Tokyo Round, and predecessor six rounds to the Tokyo Round, the United States gathered up to deal with those negotiations delegations comparable in size, or greater, than any other negotiating group.

But in between these rounds, it has been our tendency to let trade matters drift to a degree. Our role has not been as extensive in determining the precedence established within the GATT or within the system as they can be or as they should be in my view.

Consequently, I think that the essence of the new opportunity for fairer trade and an improved discipline in the system are being laid down by what we have negotiated in Geneva.

It is now strictly a question of our will, sir, in my view, in terms of whether we realize those benefits or not.

But they are within our grasp, they have been negotiated. And we must, in my view, seize them.

Senator STEVENSON. How are proved violations of the nontariff codes disciplined? Is retaliation the only way, bilateral retaliation?

Mr. MCDONALD. Actually, retaliation will rarely be resorted to if we pursue an aggressive consultation review policy in my judgement, Mr. Chairman.

The thing most nations are reluctant to face is a consensus or meeting of the minds of other nations that they have in fact acted in a way that is not appropriate for the circumstances. Consequently, in the mechanism we are building in the GATT, we are building in as much illumination and visibility in the process as we can.

One of our problems previously has been that when we had a difficulty with another nation, frequently we resorted to a bilateral discussion to resolve it.

I have been part of some of those. We sent our ambassadors to visit their officials, et cetera. We go in and make our case. We say "It's in our interest you do so and so."

They say, "Yes, but it's in our interest that we don't."

Consequently, we end up sometimes in a long and rather unpleasant diplomatic exchange with very little in the way of results.

Our focus has been to try to move it out of these bilateral discussions in which only interested parties were viewing the circumstances, and to have an option to call for a panel composed of nonparticipants to try to examine the situation and come forward with a point of view. We think that will be distinctly to our advantage because our basically open system within our domestic processes tend to favor that type of mechanism.

That was strongly resisted by some in the negotiations, but I believe we have achieved a reasonable success in that area, sir.

Senator STEVENSON. Will anything in the agreement affect our own protection of the dairy and meat producers in the United States?

Mr. McDONALD. Not fundamentally, Mr. Chairman. We have negotiated some concessions in both of those areas, and we have had in view what the impact of any concessions granted would be on our situation domestically.

I think we have come up with a balanced result. We are now having detailed discussions with representatives in both of those industries and in the hopes that we can make sure that we have treated them fairly and openly. In my judgment, I think we have.

I believe we have a very strong case in dealing with both.

Senator STEVENSON. Any progress on the treatment of U.S. banks in Japan?

Mr. McDONALD. Not directly as a part of these negotiations, sir, I regret to say. We have had very little success in dealing with services of any kind in the Tokyo Round.

Our predominant focus was on actual product tangible goods. As a side effort, though, we have initiated as a result of our discussions in the—in Geneva, a commitment on the part of the Trade Committee of the OECD to undertake a special study and a special project on problems dealing with service industries.

We have signaled to them how important we believe that that is for us in view of the evolution and our particular superiority in a number of those fields.

Consequently, we believe that should be among our top priorities for followthrough, following completion.

Senator STEVENSON. Do all the nontariff codes apply equally to developed and developing countries?

Mr. McDONALD. No, sir. In general, the nontariff measure codes of sections that provide for special and differential treatment for the LDC's.

This was in line with a declaration in Tokyo. We believe these are deviations that tended to reflect their actual stages of development and are totally compatible with the way we would see the system evolve.

We have also established as a part of the new framework mechanism, I should also add, the principle of graduation for the first time, in which we have insisted that LDC's are not all the same. We maintain that they do reflect different stages of development, and that we would expect different levels of obligations based on their individual stage of development, not only as a country, but for individual sectors or activity within those countries.

Senator STEVENSON. Do they ever graduate to the ranks of developed?

Mr. McDONALD. Faster than they would like, Mr. Chairman, I am afraid.

We have some that we have treated quite differently from others during the course of the negotiation, particularly those in the more advanced ranks of development. They feel that whether they like it or not, they have essentially graduated.

Senator STEVENSON. Has Taiwan got there yet?

Mr. MCDONALD. We have what we consider to be an excellent arrangement with Taiwan. It was fortunately completed before the end of last year. Consequently, we believe that we have quite a mutually acceptable bilateral negotiation with Taiwan.

Senator STEVENSON. Will the People's Republic of China honor these codes and, if so, where will it fit?

Mr. MCDONALD. I am sorry?

Senator STEVENSON. What about the nonmarket countries, the People's Republic of China, let's say?

Mr. MCDONALD. I would say that among the areas of continuing concern are how we interface with nonmarket economies, and how we interface with the LDC's. We think we are making more progress with the latter, frankly, than the former. We have not found an acceptable solution in terms of interface with nonmarket economies. We have made some bilateral arrangements with them. We generally have come out favorably, largely because they need individual items that we are currently supplying. For the long term we are unhappy with the measures and criteria that we are using, and this must be one of our top priorities. Up until this time, they have frequently been dealt with on political rather than economic grounds, as you can well appreciate.

Senator STEVENSON. I will enter into the record the letter from Ambassador Strauss to which I referred earlier.

[The document follows:]

OFFICE OF THE SPECIAL REPRESENTATIVE FOR TRADE NEGOTIATIONS,
EXECUTIVE OFFICE OF THE PRESIDENT,
Washington, D.C., April 4, 1979.

HON. ADLAI E. STEVENSON,
United States Senate,
456 Russell Office Building,
Washington, D.C.

DEAR SENATOR STEVENSON: I hope I am able to allay your concerns with regard to the subsidy/countervailing duty code we have negotiated in Geneva. The code does not "grandfather" all existing export subsidies employed by our competitiors. Quite the reverse—it tightens considerably the rules governing the use of such subsidies. The only grandfathering which has been done is a special rule for our DISC program.

A principal U.S. objective in the MTN—and one that was emphasized by the Congress in the Trade Act of 1974—was the negotiation of an improved international discipline on trade distorting subsidies. We believe we have succeeded in this.

With specific regard to export subsidies, the code concerns a general prohibition of their use in connection with the export of industrial products. However, there are exceptions. Export financing, provided it is consistent with the terms of the OECD Export Credit Arrangement, is *not* prohibited. In other words, our Ex-Im Bank activities are not restricted. Further, I do not see any bar to the formation of U.S. export trading companies, although clearly the specifics of any such proposal should be reviewed in light of the code provisions.

I do not pretend that the Code is perfect. However, it most certainly does *not* bless foreign subsidies while restricting our own. The Code will introduce a better international discipline on subsidized practices of all signatories. I believe that such general discipline serves the best interest of the United States and the international trading system.

Sincerely,

ROBERT S. STRAUSS.

Senator STEVENSON. I thank you again, Mr. Ambassador. You have done a very good job and assuming we do our part now, you have created a significant opportunity for American industry and agriculture. After we have done our part, it will be up to the farmers, the businessmen, all the commercial enterprises of the country to take advantage of that opportunity.

Mr. McDONALD. I was particularly pleased to be in Washington at the time of these hearings, so I could participate during these final days of negotiations. We are much encouraged by the focus of the deliberations of the subcommittee.

Senator STEVENSON. It's fortuitous.

We thank you, sir.

Senator Stewart is unable to appear today but he has submitted a statement for the record which we insert at this point as though read. Without objection I will insert in the record a copy of the subcommittee's report on U.S. export policy issued earlier this year.

[The statement, the report, and the letter containing subsequent answers to questions submitted to Mr. Robert Strauss follow:]

STATEMENT OF SENATOR STEWART

Senator STEWART. Yesterday, I had the privilege of being briefed on the status of the Multilateral Trade Negotiations by Ambassador Robert Strauss, when he appeared before the Small Business Committee.

I believe that the development of an aggressive export policy for our country in order to reduce our tremendous trade deficit is one of the greatest challenges before this Congress.

At the same time we work to develop the means and capabilities to market our products abroad, we have to see to it that other countries work toward reducing or eliminating the protectionist nontariff barriers to trade which hinder the expansion of our export capabilities. Thus, I have a strong interest in the progress in the Multilateral Trade Negotiations.

As a member of the Small Business Committee my interests naturally are in seeing the development of an export policy which insures that small as well as large business concerns have the opportunity to participate in the new markets which will hopefully open up as a result of the trade pact now under negotiation.

I am sorry I was unable to hear your testimony directly, but I will review it and I want to reserve the right to submit some questions to you for the record.

U.S. SENATE,
SUBCOMMITTEE ON INTERNATIONAL FINANCE,
March 8, 1979.

U.S. EXPORT POLICY

INTRODUCTION

Senator Adlai E. Stevenson, Chairman of the Subcommittee on International Finance, announced on January 10, 1977, a study of U.S. export policy to be conducted by the Subcommittee. The study was prompted by the rapidly mounting trade deficit and evidence that the competitiveness of United States industry in international trade and domestic markets was declining. The Subcommittee held 11 days of hearings on export policy between February and May and received testimony from witnesses from the Executive branch, industry, agriculture, labor and academic and research institutions. This report summarizes the Subcommittee's findings and makes recommendations for insuring the competitiveness of U.S. agriculture and industry in world markets.

The mammoth trade deficit has hurt the U.S. economy in many ways. It has exerted downward pressure on the exchange rate, which in turn has eroded the role of the dollar as an international unit of value, undermined the confidence of dollar holders, and prompted flight from the dollar.

Second, the deficit has had a significant inflationary impact on the U.S. economy. The increasing prices of imports as the dollar depreciates—and corresponding price increases by domestic producers of import-competing goods—spur inflation. The Treasury Department estimated in February 1978 that the first-round direct effect on the Consumer Price Index of a one percent depreciation of the dollar was only about 2½ hundredths of one percent (.025 percent).[1] But in testimony before the Senate Banking Committee in November, Charles Schultze, Chairman of the Council of Economic Advisors, estimated that the CPI goes up one to one and one-half percent for every ten percent devaluation of the dollar.[2] Schultze's estimate, which includes effects on wholesale prices and oil and raw materials imports, as well as the tendency for U.S. producers to match import price increases, is more accurate.

Third, the trade deficit is associated with job loss in import-competing industries and a slow rate of job increase in the export sector of the economy. A continuing trade deficit represents a substantial job shortfall on the export side. An estimated 40,000 jobs are created by a billion dollars of additional exports; if the United States were to eliminate its trade deficit by increasing its exports by $30 billion to match its imports, 1.2 million new American jobs could be formed.

Fourth, the slack in the economy created by a serious trade deficit and lagging export performance requires increased fiscal stimulus in

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[1] See *Export Policy* hearings, Part 1, p. 15.
[2] Senate Banking, Housing, and Urban Affairs Committee hearing "The President's New Anti-Inflation Program," November 3, 1978, p. 42.

order to keep the economy growing, in other words, a larger Federal budget deficit. Each $1 billion in exports foregone represents a loss of $2 billion in GNP and $400 million in Federal tax revenue. Reducing the trade deficit reduces the need for deficit spending by the Federal Government.

Unfortunately, the deficit may not be a temporary aberration. The "J-Curve" effect predicts that exchange rate adjustment ensures trade adjustment within one or two years. However, delayed appreciation of surplus country currencies, relatively slow growth rates in Europe and Japan and high U.S. oil imports have exacerbated the U.S. deficit and slowed adjustment.

A more fundamental problem is the extent to which the trade deficit reflects underlying changes in the U.S. competitive position which are not self-correcting. The rate of increase in productivity has been declining in the United States and is now much lower than in most other developed countries. Capital formation in the U.S. has also fallen below that of our competitors. Innovation is more difficult to measure, but many indicators suggest the United States is losing ground here as well. Trade statistics reveal that the U.S. is now facing increased international competition in high technology fields where U.S. products have been dominant for decades. A trade deficit resulting from such long-term changes in U.S. competitiveness is not susceptible to classical trade adjustment mechanisms.

The Subcommittee hearings were organized into eight parts:

1. The effect of floating exchange rates on U.S. exports and the trade balance;
2. Trends in the competitiveness of U.S. exports in specific product and market sectors;
3. Foreign government policies and programs to support exports;
4. The Export-Import Bank and the financing of U.S. exports;
5. U.S. agricultural export policies;
6. U.S. Government programs and facilities designed to support exports;
7. U.S. high technology exports; and
8. Foreign barriers to U.S. exports.

All the hearings have been printed. The chapters of this report correspond to the subjects covered in the hearings.

Chapter 1. The Effect of Floating Exchange Rates on U.S. Exports

Exchange rate depreciation of the U.S. dollar has failed to yield an improved trade balance. The explanations are many. First, depreciation of the dollar relative to the currencies of major trading partners of the United States has been modest until recently. Morgan Guaranty Trust calculates the overall change in the real exchange rate of the dollar from March, 1973 to September, 1977 to be negligible. The dollar remained at its March, 1973 level until mid-1975, then appreciated through late 1977. Thus, for a two-year period the dollar was actually about 5 percent above its trade-weighted level of March, 1973. Dollar depreciation relative to 1973 levels is a recent phenomenon.[3]

[3] The Federal Reserve estimated that the dollar's exchange value on a trade-weighted basis was slightly above the level of March, 1973 in early 1978. The dollar reached its peak value in June, 1976, 10% above its level in March, 1973, declining slightly from June, 1976 to September, 1977 and then experienced a rather sharp 7% decrease from September, 1977 through January, 1978.

The worsening of the trade balance which accompanied the dollar depreciation is partially accounted for by the "J-Curve" effect. Currency depreciation raises the price of imported goods and services already ordered, thereby increasing the value of imports. Exports are concomitantly reduced in value until increases in quantities exported can be realized. Thus, during the first six to nine months following depreciation of the dollar the U.S. trade deficit can be expected to worsen.

The Treasury Department estimated the lag between movement in the exchange rate and adjustment in the trade balance to be about eighteen months. The Federal Reserve estimated the full impact of exchange rate depreciation on exports occurs over a period of two years. Thus, the depreciation which occurred in late 1977 and early 1978 cannot be expected to result in a dramatically improved U.S. trade balance until late 1979.

However, the dollar has been subject to additional and accelerated depreciation in late 1978. The initial negative "J-Curve" effects of "new" depreciation may overwhelm the positive effects of the "old" depreciation. Continuous currency depreciation may create effects not accounted for by the "J-Curve" theory.[4]

Additionally, the failure of the U.S. trade balance to adjust rapidly to exchange rate depreciation could be due to adverse movements in relative inflation rates between the United States and its principal competitors in export markets. Most studies agree, however, that U.S. price competitiveness has improved recently. An index of relative export prices developed by Chase Econometrics shows that U.S. export prices reached a relative low point of 92.6 in 1973, rose through 1976 (when they exceeded 100 on the index), and declined to a level of 98.4 in 1977. Prices are expected to decrease further to about 91.7 by 1979, putting U.S. producers in their most competitive price position since 1973.[5]

The recent improvement in the price competitiveness of U.S. exports is due to the combined effects of dollar depreciation and relatively lower inflation than in most major foreign countries. However, some trade surplus countries, Germany and Switzerland in particular, have had lower inflation than the United States, which has offset somewhat the appreciation of their currencies relative to the dollar. If inflation accelerates in the United States, much of the gain in international price competitiveness would be wiped out.

U.S. trade performance over the past few years seems broadly related to change in price competitiveness arising from relative inflation and movements in exchange rates. Improved U.S. price competitiveness in the period 1971 through 1973, attributable primarily to the devaluation of the dollar, contributed to the substantial export surplus in 1974 and 1975. Correspondingly, deteriorating U.S. price competitiveness during 1975 and 1976 was a factor in the massive trade deficits of 1977 and 1978.

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[4] Economists disagree on the effectiveness of the "J-Curve" phenomenon. Dr. Lawrence B. Krause of the Brookings Institution in testimony before the Subcommittee on February 6, 1978 contended current dollar depreciation would lead in time to improved U.S. trade performance, but Tilford C. Gaines of Manufacturers Hanover Trust Company questioned the effects of exchange rate depreciation when rates tend to cycle or move up and down episodically. Gaines suggested only stable depreciation over a finite period of time affected trade balance. See Part 1 of the hearings on Export Policy held by the Subcommittee on International Finance, pp. 91–109.

[5] See testimony of John F. Norris, Chase Econometrics Association, Inc. *Export Policy* hearings, Part 1, pp. 124–126.

The U.S. lost competitiveness in relative export prices during the period 1975 through early 1977 as the exchange rate remained at an artificially high level while U.S. inflation was in the middle range for industrial countries. Once J-Curve effects are absorbed, increased price competitiveness can be expected to improve trade and current account balances. The Treasury Department estimates a one percent improvement in international price competitiveness produces an increase of ½ to 1 billion dollars in U.S. exports when the improvement becomes fully effective.

Another factor in the trade deficit is the difference in growth rates between the United States and the principal foreign industrial countries. Anthony M. Solomon, Under Secretary of the Treasury for Monetary Affairs testified before the Subcommittee that differences in growth rates have tended to swamp the effects of exchange rates and relative price competitiveness. The U.S. trade surplus in 1975 can be largely accounted for by the relatively low growth rate in the United States compared to that in Europe. The relatively high rate of growth in the United States in 1977 and 1978 relative to that abroad may be the principal factor accounting for the large trade deficit. Convergence in relative growth rates will be necessary in order for improved price competitiveness to have its full effect on the trade balance.

Economist Rudiger Dornbusch of the Massachusetts Institute of Technology cautioned, however, that the difference in income elasticities of exports between the U.S. and its principal competitors is so great and so unfavorable to the U.S. that foreign economies would have to grow much faster than the U.S. economy in order for the U.S. trade deficit to be reduced. Dornbusch noted that foreign growth rates are not likely to exceed the U.S. rate substantially, and concluded an improvement in U.S. trade competitiveness is required "not only to close the present trade gap but in fact to prevent it from widening." [6]

Improvement in price competitiveness and convergence in relative growth rates may reduce the trade deficit, but export levels may be determined more by government policies and non-price considerations than market-determined export prices. The principal trade competitors of the United States—Germany and Japan—pursue policies which systematically counteract improvements in price competitiveness by U.S. suppliers. Furthermore, the structure of U.S. trade, especially on the export side, may minimize sensitivity to price considerations.

The contention that the Germans and the Japanese, as well as the Swiss, the Dutch and others pursue policies designed to maintain their trade surpluses, is a familiar one. The export orientation of their economies makes exchange rate stabilization and policies to preserve comparative advantage in export markets mandatory. Thus, if the exchange rate begins to move upward, monetary authorities in these countries are likely to intervene in the markets to discourage further currency appreciation. At the same time, monetary and fiscal policy instruments are utilized to suppress the rate of inflation, thereby offsetting movements in the exchange rate to the largest possible degree.

Japan, Germany and a number of other countries place such emphasis upon export performance that they are willing to subsidize

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[6] Rudiger Dornbusch, "Flexible Exchange Rates and Macro-economic Performance: The U.S. Since 1973" paper prepared for the Tripartite meeting, Tokyo, November 14–16, 1978, p. 23.

exports at the expense of their domestic economies. An apparent improvement in price competitiveness can be offset by indirect subsidies (for example, tax incentives), special loan facilities, or other measures. Other non-tariff barriers to U.S. exports, such as government purchases reserved for domestic firms, design specifications which favor domestic producers, and government-to-government trade arrangements are used extensively by Japan and the European Community. It remains to be seen whether Japan and the European Community will tolerate the trade implications of a significant improvement in U.S. export price competitiveness.

The composition of U.S. exports and the nature of export markets abroad according to Lawrence Fox of the National Association of Manufacturers, combine to make U.S. export performance relatively insensitive to price movements. The volume of agricultural exports, which account for roughly 20% of U.S. exports, does not automatically reflect relative price competitiveness. U.S. agricultural exports to the European Community, for example, benefit little from relative price improvements because the Community's Common Agricultural Policy is specifically designed to offset such movements.

Manufactured goods exports are presumably more sensitive to changes in price competitiveness, but the disappointing performance of the United States in manufacturing exports compared to Germany and Japan, whose currencies have been appreciating and whose price competitivenes vis-a-vis the United States has deteriorated, implies that trade in manufactured goods may be less price sensitive than is commonly assumed. Relative growth rates may explain somewhat the continuing high level of exports by Japan and Germany compared to the United States, but do not account for the entire phenomenon. Fox suggested international trade is increasingly characterized by marketing strategies and pricing policies which focus on market penetration or market share, and denigrate price considerations. Marginal pricing, and even dumping, may explain some of the relatively strong Japanese and German export performance. Fox cited data which indicated Japan and Germany emphasize export pricing strategies which cause export prices to rise more slowly than domestic prices, whereas in the case of United States exports the reverse appears to be true.

In the case of large capital items where the United States generally has a comparative price advantage, sales often hinge upon such variables as credit terms, offset purchases and non-monetary factors including government decisions to favor specific foreign enterprises or investors as trading partners. Much international trade also occurs within multinational corporations, and is less sensitive to price considerations than to corporate strategies.

The lack of improvement in the U.S. trade balance may also be partially accounted for by the foreign market composition of U.S. trade. The United States' principal foreign market is Canada, and there has been no relative price improvement for the United States in the Canadian market. In the case of most non-oil-producing developing countries, exchange rates have not changed relative to the dollar and improvement in U.S. price competitiveness relative to domestically produced goods in such countries has been minimal. U.S. export performance in third world markets relative to Japanese and German suppliers should improve with increased U.S. price competitiveness, but there is little evidence of trade gains to date. Existing trade relationships, perceptions of quality, and assurances of timely delivery account for export success in many markets. Germany, Japan and Switzerland have reputations as dependable suppliers and have continued to export successfully despite deterioration in the price competitiveness of their products.

U.S. producers tend to be much less aggressive in exporting than are the Japanese and Europeans, in part because U.S. producers have fewer incentives to export. A large domestic economy and relatively good growth rates at home enable U.S. producers to expand production and enjoy profits through domestic consumption rather than relying upon exports. U.S. exporters also face more government-imposed disincentives, such as anti-trust, anti-bribery, anti-boycott and human rights restrictions and tighter controls on exports to communist countries.

In conclusion, it is unrealistic to expect rapid and significant improvement in the U.S. trade balance due to exchange rate depreciation, because: (1) dollar depreciation will improve U.S. price competitiveness only if reinforced by relatively low U.S. inflation rates; (2) trade flows will respond to relative price changes only belatedly; (3) the U.S. deficit will decline only if growth rates are higher abroad than in the U.S.: and (4) U.S. trade performance is not closely related to relative price considerations for structural reasons.

Chapter 2.—Trends in U.S. Export Competitiveness in Specific Product and Market Sectors

United States' export growth has been negligible since 1974. Export growth in nominal terms has been 7 percent per annum compared to a 13½ percent rate of increase for imports during the same period. Not only has U.S. export growth been slowing but what growth has occurred has been due entirely to price increases rather than greater sales volume. In real terms U.S. exports in 1977 were only one percent greater than in 1974. The Subcommittee's second hearing addressed the question whether the lack of real U.S. export growth reflected declining competitiveness of U.S. non-agricultural products in international markets.

Slow growth in U.S. exports is attributable in part to slow economic growth rates in traditional markets for U.S. exports. The Canadian market, the largest single market for U.S. exports, has expanded very slowly. Japan, also a large market, has grown slowly in the last two years, as have some of the major non-oil producing LDC markets—Brazil, Mexico and India—which would normally account for about 30 percent of U.S. shipments to non-oil-exporting LDCs. Thus, the U.S. share of world exports is growing more slowly than that of other industrial countries in part because the countries to which we traditionally sell have had slower growth rates than countries to which our competitors traditionally sell.

At the same time, however, the United States has failed to expand its exports in the faster-growing markets at the same pace competitors have. The United States experienced declining market shares in 1977 in exports to Japan, Italy, the Netherlands, several Latin American countries, India and Korea, as well as the important OPEC markets.

An analysis of market shares conducted by C. Michael Aho and Richard Carney indicates a disturbing pattern. Aho and Carney measured competitiveness by comparing U.S. exports to the exports of other countries in overseas markets. They examined the exports of nine OECD countries in fourteen different regions for three periods, 1965 to 1970, 1970 to 1973, and 1973 to 1976. During each of the time periods analyzed the United States lost market shares relative to Japan. The depreciation of the dollar relative to the Japanese yen did not enable the United States to recover its earlier market share of total manufactured exports. U.S. losses were particularly large in exports to the European Common Market countries.

The fastest growing importing region in the world in the last few years has been the Middle East. OECD countries' exports to the Middle East increased by more than six-fold during the period from 1970 through 1976. The U.S., Japan and Germany all increased their shares of total manufactured exports during that period, but the largest gains were made by Japan.

Relative differences in growth rates cannot explain the superior Japanese market performance in either the European Community countries or the Middle East; in both cases Japan and the United States were on the same relative competitive basis. The difference in exchange rates and price movements between the Japanese exports and U.S. exports should have led to superior U.S. export performance, but it did not.

As U.S. price competitiveness improves there is some hope for an increased U.S. market share in major markets, but non-price factors could be critical. Salesmanship, market familiarity, reliable delivery schedules, after-sales-service, product-quality and credit terms can determine the success of efforts to exploit a relative price advantage. The United States is facing increasing competition across a broader range of products, including capital goods and high technology products where the U.S. has traditionally been dominant, and must make new efforts to see that U.S. products are competitive and that U.S. Government policies do not reduce export competitiveness.

A deteriorating trend in U.S. exports is evident from an analysis of exports of research intensive products. Historically, the United States and the United Kingdom have exported products intensive in capital and research-and-development expenditures. However, in recent years both countries have allocated a smaller proportion of their gross national product to investment than have Germany and Japan. They have also had lower growth rates of real investment. Aho and Carney examined trade patterns for research-and-development-intensive commodities such as chemicals, machinery and transport equipment, scientific instruments, and miscellaneous manufactures. They found between 1962 and 1970 the U.S. share of total OECD exports of these commodities declined from 27.6 percent to 21.7 percent. By 1976 it was down to 20.5 percent. The U.K.'s share decreased between 1962 and 1970 from 15.2 percent to 10.0 percent and has continued to decline to a low of 8.3 percent in 1976. The German share has remained stable, but the Japanese share has grown steadily since 1962. In 1970 the Japanese share was 9.9 percent; in 1976 it was 13.2 percent. The U.S. decline seems likely to continue unless research and development expenditures and capital investment increase.

In the past the United States has placed a low priority on export promotion, but this priority must change if the United States is to profit from new markets. The OPEC countries, some of the non-oil-producing developing countries and Japan, where major efforts are underway to remove trade barriers, offer market opportunities which the United States should exploit. Whether U.S. business responds will depend in part upon government efforts to involve additional U.S. firms in exporting, as well as to familiarize existing exporting firms with new export opportunities and to support all U.S. exporters strongly and consistently.

Structural factors rather than price or business cycle factors explain recent changes in the pattern of U.S. exports. In addition to the fact that the United States is less export-oriented and makes less effort to expand its exports than do foreign competitors, the United States' traditional leads in productivity and technological innovation have been lost. Investment is lower in the U.S. than in a number of other countries, and there is evidence U.S. industry is shifting investment from basic research to comparatively minor product and process development in the expectation of short-term returns. These trends suggest U.S. exports will lag even further in the future.

Improvements in U.S. price competitiveness via depreciation of the dollar and lower inflation can lead to improved export performance in a number of categories—especially consumer goods—but where exports depend on reliability, quality and servicing, and for products with high technology and capital inputs, greater price competitiveness alone is unlikely to lead to major increases in U.S. exports.

Chapter 3.—Foreign Government Policies and Programs to Support Exports

Foreign government support for exports has contributed to the U.S. trade deficit. Mr. George Stathakis of the General Electric Company testified before the Subcommittee that the biggest obstacle to expanded U.S. exports is the help foreign trade competitors get from their governments.

Although fiscal and monetary policies are not generally regarded as efforts to support or subsidize exports; the restrained growth policies of Germany and Japan have been conducive to export growth, and these countries' sluggish domestic expansion has conversely blocked imports. Because the export sector is such a large part of these economies, adequate total growth can be maintained while pursuing policies to restrain inflation.

Industrial policies are an important element in export expansion for many countries. The industrial policies vary: Japan, France, and Italy rely extensively on planning mechanisms, but a number of other countries, including Germany, Sweden and Denmark, place far more emphasis on a favorable investment climate than on targeted industrial policies. Regional development schemes are also used to channel resources into industries with strong export potential.

The effectiveness of cooperation between government and industry in selecting target industries and developing them is best exemplified by Japan. The post World War II rise of the Japanese steel and shipbuilding industries to positions of world market prominence was the result of carefully planned investment and export promotion strategies. Since 1972, a government coordinated effort to boost the Japanese computer industry has been similarly successful. Another impressive aspect of Japanese industrial planning is the ability to react to overcapacity in certain industries.

A number of other countries have attempted to "target" industries with export potential. Taiwan, Hong Kong and South Korea have developed their textile and footwear industries, and in the process have supplanted their model, Japan, as a world supplier of these commodities.

Research and development in Japan and Europe is often directed toward products with export possibilities. The Europeans have worked cooperatively to increase their share of the international commercial aircraft market, at the expense of the U.S. The Japanese government has coordinated research in computers and semiconductor technology with an eye toward developing a major new export industry.

Although studies conducted to date do not seem to indicate significant trade differences arising from different applications of environmental standards or anti-trust laws, a recent study conducted for the Department of Commerce suggests that the more vigorous environmental standards in the United States may have an adverse effect on productivity in this country relative to other OECD countries which, of course, could have consequences for export growth in the future. The United States also has the most stringent anti-trust legislation; Japan's large trading companies face no anti-trust problems.[7]

Many countries use remission of indirect taxes to stimulate exports. The recent Supreme Court decision in the Zenith case confirms that such rebates do not violate U.S. countervailing duty statutes. A number of countries also have a very low rate of taxation on the income of foreign subsidiaries of domestic companies, which enables a company to establish a sales subsidiary overseas and avoid practically all taxation on export sales. The United States does not permit such differential tax treatment.

Japan, additionally, has a tax incentive system for exporters which was modified recently to emphasize incentives for smaller and medium-sized exporters. Many developing countries rely on tax incentives to stimulate exports to an even larger degree than do the developed countries.

The most important non-tax incentives are in the area of financing for exports. Most countries provide some form of official export financing, and the French, Japanese and British use supplemental non-tax incentives as well. Particularly noteworthy are the export financing incentives designed for small exporting firms in Germany, Japan, Italy and France.

Foreign governments often finance prefeasibility studies. In some cases this is complemented by government-to-government contact by top level government officials well versed in the project who assure the purchasing government that the bidding firm has full official support.

Japanese companies bidding on major construction projects can present a single, combined price offer. U.S. anti-trust statutes preclude

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[7] The incentives offered by foreign governments to their exporters are cataloged by the Special Committee on U.S. Exports in Part III of the *Export Policy* hearings, pp. 107–243.

such cooperation by U.S. firms. Cheaper export shipping is another factor in the superior export performance of our competitors. Freight rates for ocean shipping average 32% higher for U.S. exports than for U.S. imports. Even worse, rates on shipments to developing countries paid by U.S. exporters average 100% more than rates paid by major developed country competitors. Japan has a 300% freight rate advantage over the United States on shipments to third countries. Organized foreign exporter representatives in Europe and the Far East use cartel-like power to keep rates down. Another "home-grown" problem is that official U.S. Government cargo often crowds out non-Government cargo on outbound U.S. Flag carriers, allowing carriers to exact premium rates for the scarce remaining space.

The United States Government spends less each year to promote manufactured exports than do the governments of Japan, the United Kingdom, Italy and France, but more than Canada and Germany. Comparisons for fiscal year 1976 can be made on the basis of amounts spent on export promotion for each million dollars of manufactured exports. On that basis, the United States spends $340; Canada and Germany, $140; France and Japan spend about $600; Italy spends $1,400 and the United Kingdom $2,500. The German figures are understated because German exports are promoted by trade associations and overseas German Chambers of Commerce which exporters are required to join and financially support. In the United States, about 1/100th of 1 percent of the federal budget is spent for export promotion. Other countries average about six times that amount.

In conclusion, foreign governments show great scope and flexibility in their policies and programs to support exports. The use of export expansion as a tool of domestic economic management is not only well understood and widely employed but shows impressive resilience in the face of economic changes which would otherwise lead to deteriorating trade balances.

Chapter 4.—The Export-Import Bank and U.S. Export Financing

The Subcommittee held four days of hearings in March and April, 1978 on financing of non-agricultural exports and legislation to extend and enlarge the authority of the Export-Import Bank. The Subcommittee examined the deficiencies of private export financing, the growing foreign competition in official export financing, and proposals to strengthen both private and official U.S. export financing and to limit international credit competition.

The private sector finances most U.S. non-agricultural exports. The Export-Import Bank finances on the average only about 18 percent of manufactured goods exports and 21 percent of capital goods exports. But private financing is seldom available on fixed interest rate terms, or for periods longer than five years, and thus is often insufficient to support capital exports for large development projects abroad. Commercial export financing sources do not accept political risks and sometimes shy away from economic risks as well in developing countries.

Private export financing through smaller commercial banks and outside the major financial centers has been limited despite the intent of Congress to facilitate such financing when it passed the Edge Act in 1919 (Section 25a of the Federal Reserve Act). The Edge Act provided for Federal chartering of corporations "organized for the purpose of engaging in international or foreign banking." The Federal Reserve Board issued Regulation K (12 C.F.R. Part 211) the following year, giving Edge Act corporations "powers sufficiently broad to enable them to compete effectively with similar foreign-owned institutions and to afford to the United States exporter and importer . . . at all times a means of financing international trade" (211.1(b)(1)).

By early 1978 there were 115 Edge Act corporations in the United States, but statutory and regulatory limitations on Edge corporations retarded their role in financing U.S. exports. Chief among the legal restrictions on Edge Corporations were the following: (1) liabilities could not exceed 10 times capital; (2) a minimum 10 percent reserve was required even when not required of commercial banks; (3) Edges were not eligible for Federal Reserve membership; and (4) the conduct of any business in the U.S. except that "clearly related to international or foreign business" was prohibited (12 C.F.R. 211.1(b)(2)). Testimony received by the Subcommittee suggested modification of Edge Act provisions could facilitate the formation of Edge corporations by smaller and regional banks as well as enlarging the role of Edges in promoting U.S. exports.[8]

When the Banking Committee met to mark up the International Banking Act of 1978 Senator Adlai E. Stevenson proposed a series of amendments to the Edge Act. The amendments approved by the Committee and included in the Act adopted September 18, 1978, lifted the statutory restriction on the ratio of liabilities to capital and reserves; removed the discriminatory minimum reserve requirements; required the Federal Reserve Board to make recommendations which would permit Edges to become member banks; and expanded the permissible banking activities of Edges. Also, for the first time, nonbanking corporations and foreign banks are permitted to form Edge Act corporations. Once the Stevenson amendments have been fully implemented by federal regulation, the use of Edge corporations to finance U.S. trade is expected to grow significantly.

The need to supplement private export financing with Eximbank programs will continue to grow as well, however. As researchers for the Congressional Research Service have noted:

> The growing commercial rivalry among the developed countries and the increasing similarities in the price, quality and availability of their goods has meant that, in many cases, government financing arrangements have become a determining factor in some trade transactions. In the capital goods sector and the market for "big ticket" items in particular, it now often appears that contracts may go to the exporter who is able to arrange the most attractive financing for his sale.[9]

The Export-Import Bank is a U.S. Government agency originally created in 1934 to aid in financing and to facilitate U.S. exports. The Bank is directed to provide loans, guarantees and insurance for U.S. exports of goods and related services on terms and conditions competitive with those available to foreign competitors. The Bank in providing such export assistance is also directed to seek to minimize international competition in Government-supported export financing, to

[8] See *Export Policy* hearings, Part 6, pp. 140–187.
[9] *Export Stimulation Programs in the Major Industrial Countries*, p. 40.

judge whether there is a reasonable assurance the assistance will be repaid, to take into consideration the average cost of money to the Bank, and to supplement and encourage, but not compete with, private capital. The Bank must also take into account any serious adverse effect of its transactions on: (1) the competitive position of U.S. industry, (2) materials in short supply and (3) employment in the United States.

The Bank's programs include: (1) direct credits and financial guarantees for major capital goods exports requiring repayment periods of 5 years or more; (2) medium-term guarantees and discount loans to U.S. commercial banks and Cooperative Financing Facility loans to foreign financial institutions to finance capital goods exports; and (3) in conjunction with the Foreign Credit Insurance Association (FCIA), a group of private insurance companies, short-term and medium-term export insurance against political and commercial risks. The Private Export Funding Corporation (PEFCO), owned by U.S. banks and corporations, often participates in medium-term export financing together with Eximbank and commercial banks. Although the programs supported directly and indirectly by the Export-Import Bank are extensive, they frequently do not match those offered by foreign governments.

Foreign competitors support a greater percentage of their exports through official financing, and often provide more attractive terms and programs. For calendar years 1975 and 1976, Japan and France provided official export credit support for one-half their manufactured exports: the United Kingdom for one-fourth of its manufactured exports; Italy for one-eighth, and Canada, Germany and the United States for slightly over one-tenth of their manufactured exports.[10] The United States Eximbank offers a smaller percentage of official credit (averaging 42 percent) for long-term export credits than do the official export credit agencies of the other six nations. Japan also provides local cost financing, which is not available from the U.S. Export-Import Bank.

Japan, Germany, France and Italy offer insurance against exchange rate fluctuations; the U.S. does not. The United Kingdom and France offer inflation indemnity insurance; the U.S. does not. In order to encourage exports of complete manufacturing plants, Japan is now offering performance bond insurance covering 70–90 percent of possible losses. The United Kingdom also provides performance bond insurance, which is said to benefit British contractors competing for Middle East construction projects.

Several foreign countries combine foreign aid programs and official export credit programs in order to provide low-interest long-term credits to developing countries. France, for example, offers "mixed credits" for as little as 3 percent interest and as long as 25 years. The United States not only does not offer mixed credits, but its bilateral assistance program has shrunk relative to other countries and been redirected toward projects which provide fewer opportunities for U.S. capital goods exports.

The Eximbank has managed to keep its long term credits competitive with those offered by foreign governments, but as interest rates

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[10] See *Export Policy* hearings, Part 4, p. 75. Table Submitted by the Department of the Treasury.

rise in the U.S., the Eximbank will become less competitive. Eximbank programs will also be hampered in fiscal year 1980 by budget limitations imposed by the President's Office of Management and Budget Eximbank is the only official export credit agency, besides Canada's, which receives no annual appropriations, and is the only such agency subjected to annual legislated budget ceilings on its credit programs. Eximbank will exhaust its direct lending authority of $3.6 billion before the end of fiscal year 1979. Authority for fiscal year 1980 has been set at $4.1 billion by OMB, about one-third the anticipated demand for Eximbank credit.

Eximbank is also subject to political restrictions not imposed on the programs of foreign governments. Exports to communist countries are ineligible for Eximbank support unless the President has determined that support for exports to the country in question is in the national interest and, since 1974, that the country meets the stringent criteria for freedom of emigration set forth in the Jackson-Vanik Amendment to the Trade Act. Only Poland, Rumania, Yugoslavia and Hungary are currently eligible for Eximbank credits. Eximbank reviews export credits for human rights considerations as well, and upon the advice of the Department of State frequently holds up or denies credits for exports to countries with poor human rights records. In the case of South Africa, Congress adopted legislation in 1978 to deny Eximbank support for any export to the South African government and to any other purchaser, unless the Secretary of State certifies that such purchaser is observing the "Sullivan principles" on fair racial employment practices.

The Eximbank legislation reported by the Banking Committee in 1978 and subsequently incorporated in H.R. 14279 represents a significant step forward in official U.S. export financing. The Bank's authority was extended five years and its aggregate commitment authority was increased to $40 billion, against which up to $25 billion in guarantees and insurance may be charged at 25 percent of face value. The prenotification requirement was modified to increase the threshold from $60 to $100 million for credits to be submitted to Congress before final approval, and the review period during Congressional recesses was reduced to 35 calendar days.

Other important amendments to the Bank's charter included: the Chafee amendment providing that the Bank should not deny credit applications for non-financial or non-commercial considerations except where the President determines that such denial would be in the national interest and where such action would clearly and importantly advance U.S. policy in such areas as international terrorism, nuclear proliferation, environmental protection and human rights; the Stevenson amendment providing that the Secretary of the Treasury may authorize the Bank to assist U.S. producers to match official foreign credit support for exports to the United States when such foreign support exceeds international standards, and the Heinz amendment authorizing the Bank to provide financing competitive with that provided by foreign government agencies and authorizing the President to begin ministerial level negotiations to end foreign predatory export financing practices. The Bank's authority to finance agricultural and solar energy equipment exports was also expanded.

The advances achieved in the 1978 legislation are not sufficient to put U.S. exporters on an equal financing basis with foreign competitors. Political restrictions on Eximbank credit continue both with respect to communist countries and human rights violators. The Bank cannot match the mixed credit offers of foreign governments; new authority would be required to launch such financing. Finally, the effort to restrain international credit competition is foundering. Negotiations in 1978 to strengthen the international Arrangement on Guidelines for Officially Supported Export Credits collapsed because foreign governments refused U.S. proposals to place tighter limits on such support. The Export-Import Bank is not adequately equipped to meet the growing foreign competition in official export credits.

Chapter 5.—U.S. Agricultural Export Policies [11]

Agricultural exports are the mainstay of U.S. export performance, accounting for approximately 20 percent of total exports each year. Farm exports of $24.4 billion in 1977 exceeded agricultural imports by $10.8 billion. Without the net positive contribution of the agricultural sector, the total U.S. trade deficit in 1977 would have been $41.8 billion instead of $31 billion.

The agricultural trade surplus is important for the domestic economy. An estimated 1.2 million jobs in the farm sector result from exports. Moreover, every dollar earned through agricultural exports directly stimulates another dollar in domestic output.

The United States is the world's largest exporter of grains, wheat, rice, feed grains, soybeans, cotton and tobacco, and has expanded exports of livestock products and poultry in recent years. The U.S. share of the world grain market has increased in part as a result of greater exports to the Soviet Union and Eastern Europe.

But U.S. agricultural exports could be much greater than they are. Vast opportunities exist for expanded production at very nearly constant costs. Even without expanded production, surpluses are generally available for export in any given year. U.S. agricultural products remain highly competitive in terms of price and quality, but such considerations do not always determine success in agricultural trade. Treasury studies indicate ". . . the price elasticity of demand for U.S. goods varies considerably and a relatively large share of U.S. exports is accounted for by products with relatively low price elasticities of demand—agricultural products, raw materials and highly specialized capital equipment." [12]

A labyrinth of subsidies and protective devices for the agricultural sector throughout the world insulate real world agricultural export prices from movements in exchange rates. Devaluation of the dollar not only fails to increase the volume of U.S. agricultural exports, but may hurt U.S. farmers by reducing returns on foreign agricultural sales.

The United States cannot assume the continuation of its predominant position in world agricultural markets. U.S. soybean growers face growing foreign competition in soybeans, palm oil and related oil seed

[11] Part 5 of the Subcommittee's *Export Policy* hearings contains the record of a hearing on "Agricultural Export Policies" held on March 30, 1978 in Chicago, Illinois. Additional testimony and statements on agricultural exports are contained in: pt. 2, pp. 3–38, 193–216; pt. 3, pp. 244–250; pt. 8, pp. 1–28, 42–43, 150–175.

[12] See *Export Policy* hearings, Part 1, p. 6.

products. Expansion of Brazilian soybean production has enabled Brazil to capture a large share of the world market for soybeans and soybean meal. Expansion of Malaysian palm oil exports has cut into the U.S. export market for vegetable oil.

The United States is also facing increased competition in the areas of cotton and tobacco exports. The Soviet Union has taken a substantial share of the U.S. cotton market in Europe, and a number of developing countries are becoming important suppliers of cotton, including the Ivory Coast, Chad, Colombia, Turkey, Iran and Afghanistan. Korea, Brazil and Malawi have increased their tobacco exports.

The United States faces increasing competition in fresh and processed fruits and vegetable exports from Morocco and Israel. Taiwan has emerged as a major exporter of a number of horticultural products. Brazil has replaced the United States as the world's leading exporter of concentrated orange juice, and almost every Mediterranean country is now actively involved in exports of tomato products.

United States exports of livestock products such as hides and skins, tallow, greases and variety meats, are encountering strong competition from Australia, Canada and Southeast Asia.

The Department of Agriculture testified before the International Finance Subcommittee on February 23, 1978, that the principal factor affecting U.S. agricultural export sales is foreign tariff and nontariff barriers to U.S. products. The European Community's Common Agricultural Policy, for example, provides for heavy subsidization of high-priced EEC wheat and flour to make them competitive in the world market. Even where subsidization is not formal, arrangements for grain marketing provide opportunities for monopoly pricing. Australia and Canada have wheat boards which control most aspects of wheat trading, including the pricing, financing and marketing terms for their exports.

The wheat boards in Canada and Australia are in a position to enter into long-term supply arrangements, and have done so with the People's Republic of China and the Soviet Union. Such arrangements presumably have included favorable pricing and financing for the buyers, but detailed information on the arrangements is not available in the United States.

The Canadian wheat board has a monopoly over Canadian wheat marketing, including transportation and exports. The Board finances its operations with bank credits guaranteed by the government. The Australian wheat board receives credit through the reserve bank of Australia. The wheat boards have full authority to set prices on all sales. By following the markets, they can determine what U.S. prices are likely to be, and offer their wheat at a lower price. There have been a number of examples of wheat board sales on concessional terms and with repayment periods of more than three years.

Canadian grain is also subsidized by favorable rail transportation rates for movement to export ports. The Australian wheat board charters its own bulk carriers, thereby enjoying lower freight costs, and the board follows a destination pricing scheme which enables Australian wheat to be competitive in any overseas market.

The European Community uses export subsidies to reduce its surpluses and strengthen prices, particularly in the Community's soft wheat market. Individual member countries of the European Community offer long-term credit and low interest rates to make grain prices even more attractive; financing is supplied through private banks operating under a government subsidy scheme.

Brazil has used an indirect export subsidy for soybean products. Brazil provides funds at preferential interest rates to exporters in proportion to their exports of soybean products. Exporters can relend the funds on the domestic Brazilian market at substantially higher interest rates and use the differential as a bonus with which they can reduce their prices to foreign buyers of soybean products. Exporters also received a government subsidy on domestic sales of soy products, which helps them to make a profit on overall operations. Brazil also provides a tax subsidy for all exports. Brazil has made various changes in its subsidy programs recently, but the basic system remains intact.

Rice exports have been subsidized by Japan, Thailand, Taiwan and the People's Republic of China. Information on export subsidies is limited, though, and the exact terms of various sales are difficult to confirm.

The efforts of many countries to preserve inefficient domestic production and the efforts of developing countries in particular to expand agricultural exports hamper U.S. export growth. Reductions in foreign import barriers and export subsidies is the major avenue through which U.S. agricultural exports could be increased. Dr. William R. Cline of the Brookings Institution testified before the Subcommittee that: ". . . foreign protection is much more severe than U.S. protection. Agricultural quotas in Japan and variable levies in Europe limit our exports . . . If the tariff equivalent of agricultural non-tariff barriers were cut by approximately 40%, U.S. agricultural exports would rise approximately $500 million per year." [13]

Improved financing programs could also help boost U.S. agricultural exports. Other countries have greater flexibility in the kinds of credit they are able to offer in order to obtain foreign sales. The Department of Agriculture's Commodity Credit Corporation and concessional food aid under P.L. 480 Title I financed about 5.6 percent of U.S. agricultural exports in 1976.

Witnesses appearing before the Subcommittee supported extension of the maximum period for repayment of Commodity Credit Corporation (CCC) financing of U.S. agricultural exports from three years to ten years. They also recommended making presently ineligible non-market economy countries eligible for CCC credits. John W. Curry, President of the National Corn Growers Association, estimated corn exports alone would expand by 53% to approximately 2.9 billion bushels by 1981 if CCC credit were provided to all non-market economies.[14] Curry and other witnesses recommended CCC financing of infra-structure projects to handle U.S. agricultural commodity imports in less developed countries. Witnesses agreed that expanded CCC credits should not be subjected to U.S. cargo preference requirements which would increase costs, induce delays and add to administrative complexity.

The Agricultural Export Trade Expansion Act passed by the 95th Congress should yield significant improvement in financing of U.S.

[13] See *Export Policy* hearings, pt. 8, p. 26.
[14] See *Export Policy* hearings, pt. 5, pp. 24–25.

agricultural exports. CCC support will be available on ten-year terms for limited purposes. Short-term credit will be available for the first time for exports to the People's Republic of China. The Department of Agriculture's Foreign Agricultural Service will be expanded and overseas representation upgraded. The Act closely parallels S. 3011, introduced by Senator Adlai E. Stevenson on April 27, 1978.

Expanding exports from the world's most efficient producer, rather than forcing U.S. taxpayers to subsidize decreased production and suffer inflated prices, makes sense in a world plagued by food shortages. The U.S. Government should strive to obtain greater and more stable access to world markets, and to provide U.S. agricultural producers with export support equal to that provided by other governments. By negotiating elimination of foreign tariff and non-tariff barriers the United States could increase beef exports to the EEC and Japan for example, by as much as 1,000 percent (current U.S. per capita beef consumption is nearly 18 times greater than beef consumption in Japan).

The United States faces increased competition in most foreign markets and products in the next decade, and should give increasing attention to measures which could reduce the production costs of U.S. agricultural products. The United States should also remove self-imposed export barriers, and may need to establish trading companies in the agricultural area which can compete with the wheat boards and grain boards of foreign competitors or empower the CCC to negotiate with nonmarket countries. Larger grain reserves may also be needed to enhance U.S. reliability as a supplier. But the principal necessity is a reduction of foreign barriers to U.S. agricultural exports.

CHAPTER 6.—U.S. GOVERNMENT PROGRAMS AND FACILITIES TO SUPPORT EXPORTS

A variety of U.S. Government programs and institutions are designed to help U.S. producers compete more effectively in world markets. However, the programs are uncoordinated, the institutions underutilized, and the overall effort insufficiently directed toward the exporters in greatest need of assistance.

The agency primarily responsible for trade promotion is the Industry and Trade Administration of the Department of Commerce. ITA attempts to educate potential exporters via media campaigns, regular publications, and extensive contacts with private export promotion institutions. It offers counseling services on exporting in general and advice on specific countries. In-depth reports on exporting techniques, prospects for particular industries and business conditions throughout the world are published regularly. Special reports on U.S. products with sales potential in key overseas markets are also distributed. Contact with foreign importers is encouraged through the distribution of lists of overseas buyers and recruitment of foreign buyers for trips to the United States.

Overseas product promotion is attempted via exhibitions at U.S. Trade Centers and international trade fairs. Counseling assistance and contact lists are provided to U.S. businessmen abroad, and market opportunities for new U.S. products are negotiated with major foreign department stores.

Despite the range of ITA activities, the programs are not so successful as they could be. Experienced firms are often the main beneficiaries of Commerce Department efforts, seeking assistance not because they need incentives to export, but to lower costs. Small firms and inexperienced exporters are often unaware of existing programs, or require specially tailored services the Department cannot provide. The export promotion programs have suffered a 14 percent reduction in real outlays over the past 7 years.

Overseas market information and direct assistance abroad (with languages, customs, etc.) are regarded by exporters as two of the most valuable services provided by the government, yet for these ITA must rely heavily on cooperation from State Department Commercial Officers stationed abroad. Despite the important role commercial sections play in the administration of Commerce Department programs abroad, Commerce has no control over the selection, assignment, promotion and support of Commercial Officers. Within the Foreign Service hierarchy commercial posts have little prestige, and morale problems have repeatedly been reported.

More serious than the inability of the Commerce Department to supervise administration of its overseas programs is the Department's lack of control over export policy. Export activities are subject to uncoordinated and sometimes conflicting demands from different government agencies. In the face of competition from countries like Japan and Germany which achieve considerable coordination in these matters, the inability of the U.S. to promote cooperative export expansion efforts and synchronize export policies is a serious disadvantage.

Legislative efforts to enable U.S. exporters to compete with foreign banks and cartels in overseas markets date back over sixty years. The Webb Pomerene Act (1918) exempts the formation and operation of Export Trade Associations from some prohibitions of the Sherman and Clayton Acts, but its provisions have been singularly underutilized. Only 28 such Associations exist today, accounting for less than 3% of U.S. exports.

The principal reason for the Act's failure is its vagueness. Because no definitive standards are prescribed for permissible activities, Webb associations have repeatedly been challenged by the Justice Department. Facing the likelihood of an antitrust investigation and with no clear idea of permissible activities and possible benefits under the Act, firms have been reluctant to form Export Trade Associations.

The 1919 amendments to the Federal Reserve Act known as the Edge Act sought to involve small and regional banks in the financing of exports, thereby stimulating export opportunities throughout the country. It allows banks to combine to form Edge corporations for the purpose of engaging in international banking and export financing.

Although the number of Edge corporations has increased steadily since the Act was "rediscovered" in the late 1950s, it has not been exploited by the small and regional banks it was intended to serve. The prime beneficiaries of the Edge Act have become the largest banks, which have increasingly made sophisticated use of the statute as a vehicle for foreign equity financing related to lending or investment policies of the parent bank, or for the acquisition of overseas banks and financial institutions.

Limitations on aggregate liabilities, the types of business open to Edge Corporations and tight reserve requirements have been among the factors constraining widespread use of the Act in support of foreign trade. However, significant changes in these provisions were made in the International Banking Act of 1978.[15]

The Export-Import Bank, established in 1934, and its programs—direct loans, financial guarantees, insurance and discount loans—are discussed in detail in Chapter 4 of this report.

Although the clear intent of the majority of U.S. export promotion programs and institutions is to provide assistance to small and inexperienced exporters, they have persistently failed to do so. Among the 25,000–30,000 existing exporters, the 95% who are small and medium sized still account for only 15% of total exports. The Department of Commerce estimates an additional 20,000–30,000 small companies could export successfully, but have not done so, hampered by inexperience or unawareness of available opportunities.

In many respects, one of the most important impediments to the active involvement of smaller companies in exporting is the inconsistency and confusion surrounding the few assistance programs offered by the government to help exporters. One clear example of this is the Domestic International Sales Corporation (DISC) Program, establish in the Revenue Act of 1971, which offers exporters deferred taxes on export income.

Although there is evidence small company exporters have increasingly made use of DISC provisions since 1971, over 60% of total DISC benefits have gone to parent corporations with more that 250 million in assets. A Treasury Department analysis of the program concluded the legal and accounting costs of complying with the complex DISC legislation inhibited small company participation in the tax benefits. Subsequent reductions in the program, and the possibility of its recision have further hindered potential small firm users.

Small firms are similarly ill-equipped to deal with the bureaucratic requirements of the export license application process or to whether attendant uncertainties and delays. They require special guidance in coping with other legislative and administrative problems, as well. Corporations with vast experience abroad and large legal staffs may successfully avoid entanglement with antiboycott, corrupt practices, human rights and environmental protection regulations which intimidate or ensnare smaller firms. Inexperienced firms, whether large or small, often perceive these barriers as insurmountable.

Despite recent efforts of the Department of Commerce to focus its support activities on small and inexperienced exporters, foreign trade remains the province of the largest U.S. corporations. Significant export expansion requires involving a much broader segment of the American business community in exporting, and will depend upon a more consistent and supportive U.S. Government export policy.

Chapter 7.—U.S. High Technology Exports[16]

Technology is a key factor in U.S. exports and has contributed strongly to U.S. export growth. Technology-intensive products, as

[15] See Chapter 4 of this report.

[16] Testimony on this subject is contained in part 7 of the Subcommittee's hearings and pp. 45–150 of part 8.

measured by R&D input, account for approximately 40 percent of U.S. exports. By contrast, R&D-intensive exports comprise only 28% of the total exports of Germany, Japan, France and the U.K. Our continued export competitiveness is clearly tied to our comparative advantage in technological innovation and the production of high technology goods.

The development of advanced technology is dependent upon high levels of government and private R&D investment. However, government support has dropped over the past 15 years, and private sector expenditure has not increased sufficiently to offset this decline. Moreover, because the orientation of private sector R&D often differs from that of government funded research, these cannot be viewed as interchangeable sources of support. Whereas private R&D tends to be market-oriented with a short to medium-term payoff in view, only the government is a significant investor in long term, basic research.

Spending by both the Federal government and business on R&D performed within industry is most closely related to export competitiveness. Although industry funding of this "industrial" R&D has averaged a 3.8% annual gain in real terms since 1966, the government's share has declined an average 5.5% per year, and overall levels have barely kept up with inflation. Research performed by industry for government agencies such as NASA and DoD has traditionally been more "basic", yet it has led to some spectacular commercial applications—the wide-bodied jet and integrated circuit technology are just two such spinoffs.

U.S. investment in R&D as a percentage of GNP has declined 25% over the last 15 years,[17] while foreign competitors have steadily increased their R&D levels. The U.S. still leads, of course, in total R&D outlays, but Japanese and German support for R&D as a percentage of GNP has equalled that of the U.S. Moreover, foreign R&D tends to be strongly oriented towards the development of commercially marketable, and particularly exportable, products. Our high-technology exports are still a strong factor in our overall export performance, but our positive balance in such goods is diminishing. Statistical studies which show a significant correlation between R&D spending and export levels portend poorly for future U.S. exports if R&D spending in this country continues its relative decline.

There is evidence that private sector R&D is inhibited by unfavorable tax provisions and government regulatory actions. R&D investment—especially in basic research—is a high risk venture and a function of anticipated returns balanced against costs. If various legislative constraints (pollution controls, etc.) reduce the likelihood of payoff and if tax incentives are as good or better for other investments (such as advertising) businessmen will invest less in R&D because there are more attractive alternatives.

Foreign governments, recognizing the importance of basic research, seek to minimize disincentives. Not only do they provide substantial direct funding for commercially oriented R&D, they allow firms to pool resources in cooperative research efforts. U.S. anti-trust laws, which by and large prohibit such activity, may adversely affect our international competitive position. Collaborative efforts by U.S. firms may

[17] It should be pointed out that this statistic distorts the case slightly, because GNP is growing faster in the service sectors, which are less R&D intensive.

be more than a good idea; they may be indispensable in order to reverse declining U.S. export competitiveness.

Export of high technology final products should be encouraged because of the immediate and long-term positive impacts on employment and the balance of payments. Exports of R&D-intensive equipment used in the production of final products, when the manufacturing know-how already exists in other countries, should also be encouraged.

A central U.S. Government department responsible for export expansion, domestic industrial growth and maintenance of our long-term innovative advantage might provide the mix of expertise, flexibility, control and perspective necessary to move exports rapidly when desirable and restrain them sensibly when it is in our long-term interest to do so. The United States Government should at minimum seek to establish a basic framework within which business can move quickly and confidently. Firms must be able to plan over the long-term, knowing that those elements of the cost picture determined by government will not increase during the development stages of projects. As the situation now stands, we are losing our competitive position in high technology trade, and uncoordinated Federal Government policies make it difficult to remedy the situation.

CHAPTER 8.—FOREIGN BARRIERS TO U.S. EXPORTS

Rising protectionism has over the last three years alone caused an estimated $50 billion decline from world trade potential.[18] The United States' share of this loss has been disproportionately high; according to a recent Department of Labor study over 424,000 jobs and $7.5 billion in export sales have been blocked by foreign tariff barriers on non-agricultural products.[19] Put another way, elimination of these tariffs could reduce unemployment by 12.5% and increase exports to our major trading partners by 21%. In Ambassador Wolff's words, ". . . codes of behavior that will accord to the U.S. the same degree of openness in foreign markets *that we provide* in the U.S. markets would clearly yield major benefits for U.S. exports." [20]

Tariff barriers appear to be used strategically by foreign competitors to develop desired new industries rather than to protect inefficient old industries. For example, Japan has high tariffs on color film and computers. In the case of color film—years of protection have enabled Japan to grow into Kodak's strongest competitor. In the computer field, high tariff walls have been combined with large-scale government funding for R&D and "buy national" procurement to foster the development of an indigenous Japanese computer industry, now ready to penetrate and perhaps ultimately sweep world markets as the Japanese consumer electronics industry already has.

Despite progress in "tariff liberalization" during the Kennedy Round, the problem of non-tariff barriers, which is now perceived as more serious than tariff barriers for many U.S. exports, did not receive sufficient attention. An extraordinary variety of non-tariff barriers exist. Some are intentional, some unintentional and many impossible to definitively categorize. Bourbon (from grain) is considered

[18] See *Export Policy* hearings, Part 8, p. 2, Testimony of Alan W. Wolff, Deputy Special Representative for Trade Negotiations.

[19] See *Export Policy* hearings, Part 8, pp. 18–19.

[20] *Op. cit.*, p. 19.

injurious to health in France and therefore cannot be advertised, while Cognac (from grapes) is healthy and can be. The most common nontariff barriers include government procurement policies, regulations, standards, customs procedures, border tax adjustments, quantitative restrictions and direct or indirect export subsidies.

Government procurement is relatively open in Germany and the U.S., but in most foreign countries domestic suppliers are given significant preferences. In many nations government procurement practices are more a matter of tradition than policy—buying foreign made goods is viewed as disloyal.

Japan concentrates most trade in the hands of a few trading companies. Intimate business/government relations allow for unwritten import-reducing policy actions. In the developing countries "discretionary" import licensing is widely used and abused. In the non-market economies, state trading companies select imports as well as exports without necessarily basing their actions on relative prices.

The trade barriers presented by product standards and regulations are similarly difficult to deal with. Inspection for health certificates, for example, may be required according to a given country's laws *during the production process*—amounting to a total barrier to trade.

Border tax adjustments are considered by our electronics industry to be "the most pervasive and strongest of trade barriers erected against (its) products.[21] According to testimony, the problem is not being addressed in the current MTN negotiations.

It will take vigilance and strong bargaining just to maintain our world export potential in the face of these subtle and sophisticated barriers. Remedies outside of the MTN are difficult to perceive. One witness could only suggest that [22] Congressmen individually be firmer in talking to foreign visitors. The U.S. must not lose sight of the basic strength of its competitors—a more cohesive attitude towards exports with close government/business cooperation. Ambassador Wolff suggested should the negotiations fail, "we as negotiators have no reason to oppose retaliatory procurement policies, an expansion of Buy America domestically." [23]

Protectionist measures tie resources to less productive uses, restrict growth of productive sectors, and entail high costs for the consumer in the form of reduced choices and increased prices. They additionally tend to transmit recession, divide the world politically and contribute to general stagnation. The potential gains from freer world trade are immense, and far outweigh the hardship and dislocation caused particular domestic industries and geographic areas. However, unless adequate adjustment assistance is provided, formidable domestic political pressures can block trade liberalization efforts.

The success of the MTN package may depend upon a stronger U.S. bargaining position when faced with foreign violations of the new rules of conduct. A vast array of U.S. export support measures, either in effect or available if needed, would strengthen the U.S. negotiating position. Instead of retaliating with trade restrictions which raise import costs and hurt American consumers, the U.S. could be in a position to respond with export incentives which expand trade and create U.S. jobs without inflation.

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[21] *Op. cit.*, p. 32.
[22] *Op. cit.*, p. 12.
[23] *Op. cit.*, p. 13.

CHAPTER 9.—RECOMMENDATIONS

The United States is awakening slowly to the fact that U.S. competitiveness in world markets is slipping. Not only Japan and the Western European countries, but also the developing countries of Latin America, Asia and Africa, are becoming strong competitors for U.S. producers across the full range of industrial and agricultural products and services.

Floating exchange rates alone cannot restore U.S. trade competitiveness. Nor can the United States afford to permit the international value of the dollar to erode indefinitely; the cost in domestic inflation, capital outflow, OPEC oil price increases and declining international confidence in the United States would be intolerable. As long as the dollar is the sole reserve currency and its value is uncertain, levels of international trade will be diminished. A strong national export policy is needed to strengthen the dollar as well as reduce the trade deficit.

The Subcommittee recommends the following actions: (1) organize the Executive branch to conduct a co-ordinated, forceful U.S. export policy; (2) facilitate organization by U.S. industry and agriculture to expand exports; (3) redirect and expand existing export promotion programs; (4) provide efficient tax and non-tax incentives for research and development and innovation, as well as exports, by U.S. industry and agriculture; (5) expand export financing to meet foreign competition; (6) negotiate reductions in foreign barriers to U.S. exports; and (7) reduce U.S. Government restrictions and disincentives imposed on U.S. exports.

EXECUTIVE BRANCH ORGANIZATION TO SUPPORT EXPORTS

The United States alone among the major trading countries has no single government agency with authority and responsibility to advance its trading interests. Other countries rely upon trade ministries to help their exporters investigate markets abroad, develop new export products, coordinate export bidding, arrange subsidized financing, insurance and shipping and bargain with foreign governments to assure market access.

Two approaches are possible to organizing the Federal Government to support exports. A new Department of Trade incorporating most trade-related government activities could be established, or an Office of International Trade could be established in the White House with authority to orchestrate the trade-related actions of all government agencies.

Creation of a Department of Trade need not entail additional Cabinet posts nor additional expenditures. The Office of Special Trade Representative, a Cabinet office, could be merged with the trade functions of the Departments of Agriculture, Commerce, State and Treasury to create a new department which could absorb the International Trade Commission and Export-Import Bank as well.

An alternative would be to expand upon the STR's Office, giving it authority not only over trade negotiations, but also to coordinate export promotion and trade disputes. The unhappy experience of the Council on International Economic Policy may have unduly discouraged consideration of this alternative. What CIEP lacked in statutory authority and support from the President are not defects inherent in the concept of a White House office to manage international trade policy.

The International Finance Subcommittee has not held hearings on possible reform of executive branch organization to support exports, but its export policy hearings do point clearly to the need for U.S. exporters to receive more centrally co-ordinated U.S. Government support. It would appear particularly useful to merge the system of commerical officers provided by the Department of State with the system of export promotion operated by the Department of Commerce. A career service in international trade should be established even if no other reorganization steps are taken. International trade specialists of the highest caliber are more likely to be attracted and retained by a career service which offers rotating assignments abroad, in Washington, and in U.S. field offices.

ORGANIZING U.S. INDUSTRY AND AGRICULTURE TO EXPORT

United States policy has long been inconsistent toward organizing U.S. industry and agriculture to meet competition in foreign markets. U.S. antitrust law applies beyond U.S. borders to prevent combinations which could restrain trade within the United States. The Webb-Pomerene Act of 1918, authorized the formation of export trade associations so long as they did not reduce competition within the United States. The purpose of Webb-Pomerene was to enable U.S. exporters to compete more effectively against foreign cartels. However, the vague wording of the Act and narrow interpretations by the Justice Department, the Federal Trade Commission, and U.S. Courts have discouraged formation of export trade associations.

The Webb-Pomerene Act could be revised to expand the scope of permissible activities by export trade associations; services such as engineering, construction, insurance and finance, could be included. The Justice Department could be required to issue clear guidelines and offer advisory opinions on interpretation of the Act. The Commerce Department could be directed to assist and encourage the formation of export trade associations. U.S. exporters could be explicity permitted to form consortia to bid on major foreign projects abroad, as their foreign competitors are permitted to do.

But Webb-Pomerene may be too weak a reed on which to rely reliance for organizing U.S. exporters. The United States needs trading companies able to organize the exporting efforts of small and inexperienced U.S. firms, to conduct marketing on a global basis and absorb exchange rate fluctuations, just as Japanese and Korean trading companies do. Anti-trust law should be modified as necessary to permit formation of such trading companies. Informal interpretation of anti-trust law will not suffice—most firms will not take even a small risk of incurring criminal penalties, nor should they. Grey areas in anti-trust law are minefields for the unwary; clearly demarcated boundaries are needed.

Export trading companies should be free to market goods and services around the globe and their profits should be eligible for tax deferral, that is, not be taxed until distributed in the United States. Only with such freedom of maneuver can U.S. producers take on the Japanese trading companies and bidding consortia organized by European governments. The United States should continue international efforts to reach agreements restricting export cartels, but U.S. exporters and the U.S. economy can no longer afford to bear the full cost of foreign recalcitrance on anti-trust practice.

REDIRECTING AND EXPANDING U.S. EXPORT PROMOTION PROGRAMS

The Commerce Department has recognized that its export promotion efforts need to be targeted more toward new-to-export and new-to-market firms.[24] Smaller, less experienced firms would be major beneficiaries of improved export promotion services because such firms have less access to private sector exporting information services and less opportunity to travel abroad and to meet potential foreign buyers. Commerce has developed a strategy for redirecting its services to better meet such objectives, but funding levels are inadequate at present to permit significant improvement in export promotion activities. Congress should appropriate sufficient funds to the Commerce Department for fiscal year 1980 to enable the Department to carry out an expanded and reoriented export promotion program. Commerce should give greater attention to exports of services, which promise to be a growing portion of U.S. exports. U.S. service industries have special needs by way of export support, and Commerce should be organized to meet those needs. Commerce should provide loans to small firms and export associations to cover initial marketing costs in new export markets and for new-to-export companies. Repayment would be based upon export sales. The Commerce Department should work more effectively within the United States through its District Offices and State and local trade and economic development offices to reach companies with export potential but lacking export experience. Both at home and overseas Commerce should concentrate its efforts on new exporters and new, rapidly growing markets.

Business has a responsibility to provide for self-education, as well. The professional business associations have given little attention to export education for their members. Experienced industrial firms and banks should conduct programs through their subsidiaries and correspondent banks to deliver exporting assistance to firms outside the major cities. If relations between Government and business were more cooperative, instead of adversarial, the Commerce Department, Export-Import Bank, Treasury Department and Federal Reserve Board would join with the business associations in fostering and conducting an export expansion drive.

PROVIDING EFFICIENT INCENTIVES FOR R. & D. INNOVATION, AND EXPORTS

Tax incentives should be used to stimulate higher levels of research and development than would otherwise occur in our "maturing" economy, and to encourage producers to make the extra effort required to enter foreign markets. Tax incentives may also be justifiable to enable U.S. producers to match European and Japanese competition in third country markets as long as competing countries continue to provide significant tax incentives to their exporters.

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[24] See "Export Promotion Strategy and Programs", pp. 198–429 of *Export Policy* hearings, Pt. 6.

The United States has three tax policies which encourage exports: DISC, deferral on foreign corporate earnings, and Section 911 tax relief for certain personal income earned abroad. DISC may not be a particularly efficient incentive but exporters believe DISC is essential to profitable exporting. Removal of DISC without providing a superior tax alternative could lead to a large reduction in U.S. exports. Accordingly, DISC should be retained until another, more efficient tax incentive can be put into effect.

The export benefits of DISC could be expanded in two ways. Smaller companies not directly involved in exporting but supplying parts and components used in exports can set up DISCs to sell to the exporting firms. In this way the benefits can trickle down to smaller businesses. Use of DISC in this way is permissible at present, but has received little encouragement from the Government. Small firms may be unaware of this opportunity and may also be discouraged by the requirement that DISCs be formally incorporated. The incorporation requirement seems a needless expense for firms to incur.

Second, the money flowing into DISCs could be recycled to finance additional exports if it could be re-lent to other firms or foreign purchasers. The Export-Import Bank could use its resources in parallel with DISC funds to multiply the export punch of the DISC incentive.

DISC violates GATT rules and may come under further pressure as a result of the subsidies code being drafted in the Tokyo Round. If DISC is barred, Congress should study alternatives, including a value-added tax with rebates for exports. The VAT system is widely used abroad, is consistent with GATT rules and could be used to fund a portion of social security benefits. VAT is often criticized as being inflationary as well as regressive in impact; however, these effects could be mitigated if VAT were adopted in conjunction with other tax changes. Many foreign countries have adopted VAT systems within the past two decades and their experience should help Congress determine what costs and benefits VAT would entail for the United States.

Another alternative to DISC would be to defer taxation of export sales abroad attributed to an export sales subsidiary. At present the United States attempts to restrict use of such "tax haven" arrangements by requiring such income to be reported as current earnings. The U.S. practice reduces the export incentive effect of the general deferral of taxation on income earned abroad, contrary to the practice of other governments. To be most effective, U.S. policy should encourage the formation and use of export sales subsidiaries by consortia of U.S. firms.

Section 911 of the Internal Revenue Act provides exemption for some forms of personal income and expenses by U.S. citizens working abroad. Favorable tax treatment is an important export incentive in the engineering and construction industries, which in turn stimulate additional U.S. goods exports. The effect of Section 911 on U.S. exports requires careful examination and the tax incentive should not be reduced prematurely.

Over the long term, the most significant way to promote exports is to improve U.S. industrial competitiveness by encouraging innovation and productivity growth. The important circularity of causation between trade and domestic industrial growth should be more widely recognized, and U.S. industrial and export policies should be correspondingly integrated. The President's annual Economic Report should contain a section specifically reviewing developments in capital formation and research and development, with evaluation of the export implication of such developments.

In particular, the pivotal importance of innovative small businesses and research-intensive industries should be acknowledged. Tax policies and securities regulations which have seriously affected the rate of formation of new ventures need reconsideration, and incentives used in a number of foreign countries to stimulate R. & D. should be investigated.

For example, several Western countries, including Canada and West Germany, allow immediate write-off of research-related capital investments. The West Germans also permit R. & D. venture companies to depreciate up to three times the original investment in the venture before being subject to corporate income taxation.

An investment tax credit for research and development expenditures on "intangibles" could stimulate higher levels of R. & D. Another possibility would be to increase the existing investment tax credit for capital expenditures that are research-related. Alternative incentives could involve accelerated depreciation for capital equipment embodying new technology or capital with research and development uses.

Industrial innovation is hampered by barriers to cooperative research imposed by the government in the name of competition. The extent to which current antitrust restrictions and Justice Department policies inhibit industry from collaborating to make optimal use of R. & D. resources should be reassessed. Indeed, it is time to move beyond the traditional adversarial government/industry relationship and examine the possible gains from cooperative research institutes, funded by business and government, with university participation. Such three-way cooperation has been successful in basic research efforts in the past; work in a broader range of areas, including the development of commercial technologies, should be explored.

More effective commercialization of existing federal research would also be beneficial for exports. Greater industry involvement in the selection and management of government funded projects could help insure that the results are commercially viable. Restrictive agency patent policies, conflict of interest rules and other impediments to innovators working on federal contracts demand reconsideration.

Finally, the United States must awaken to the fact that technology transfer is no longer a one-way street. In an age where two-thirds of all research and development takes place outside the United States, our channels for acquiring foreign technologies and scientific information are woefully inadequate. The United States has, relatively, far fewer science attachés abroad than do European countries, Japan and the U.S.S.R. Moreover, the activities of U.S. science attachés are largely oriented to the administration of science agreements rather than the search for foreign-developed advanced technologies. The links between science attachés and U.S. firms operating abroad are weak, where they could be immensely valuable. There is little sense of the potential commercial gains from encouraging and assisting U.S. firms to obtain foreign technologies. Bolstering the commercial awareness of science

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attachés and strengthening the technological awareness of commercial attachés in order to improve the two-way flow of technology are far more promising strategies than trying to limit the outflow of American technology.

EXPANDING EXPORT FINANCING

The Export-Import Bank and the Commodity Credit Corporation are the primary U.S. government institutions providing financing for U.S. manufactured and agricultural commodity exports respectively. Both face political as well as economic constraints on funds and the markets in which they can operate—constraints not faced by corresponding institutions in competing countries.

Eximbank is required to obtain approval in an appropriations Act each year for its level of direct lending. The Office of Management and Budget has tended to regard Eximbank as a drain on the Federal budget despite the Bank's essential role in expanding U.S. exports, and thereby, profits, employment and Federal tax revenue. The budget proposed for fiscal year 1980 would permit the Bank to provide only one-third of the direct loans for U.S. exports expected to be requested from the Bank. Because Bank support is the determining factor in two-thirds of the export sales it supports, and because the value of the exports supported averages twice the value of the Bank's direct loans, as much as 10 to 15 billion dollars in U.S. exports may be foregone due to the ceiling imposed on Eximbank activity in fiscal year 1980 by OMB.[25] Congress should increase Eximbank's direct loan authority for fiscal year 1980 to 12 billion dollars from the 4 billion level approved by OMB. Congress should also review the budgetary treatment of the Bank to determine whether such treatment accurately reflects the fiscal impact of Bank activities.

Eximbank policies should also be changed to increase the support it can provide for U.S. exports. The Bank should end its practice of returning an annual "dividend" to the U.S. Treasury. No public purpose is served by shuffling U.S. Government funds from one account to the other. Eximbank need not perpetuate a fictional financial independence. All the Bank "profits" should be added to Bank reserves available to meet possible default by foreign purchasers.

Eximbank should also consider adopting some of the export-supporting programs offered by foreign official credit agencies: performance bond guarantees, financing for prefeasibility studies and increased local and foreign content financing. The Bank should abandon its 5 million dollar threshold for direct credits and financial guarantees, because the threshold limits access to the Bank by small exporters. The Bank should consider joint export financing activities together with counterpart institutions in other exporting countries.

Congress should make Eximbank and CCC support available, subject to periodic review, to all countries with which it is U.S. policy to encourage trade. Large potential markets for U.S. goods and services are being conceded to foreign competitors because Eximbank and CCC cannot assist U.S. exports to certain countries.

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[25] Ten billion dollars in lost exports would represent 20 billion dollars in lost GNP, 4 billion dollars in lost tax revenue, and 400,000 lost jobs.

Another area of growing competitiveness is the provision of low-interest, long-term loans to poorer developing countries for capital goods imports. Except in rare instances, Eximbank cannot afford to match foreign credits to developing countries which combine concessional development support with export financing, so-called "mixed credits." In addition, many developing countries would like to purchase goods and services from the U.S., but cannot meet the Bank's normal credit standards.

To meet this dual challenge, Congress should authorize a new Bank program to provide export financing for sales to countries with per capita income below $1,000. Financing could be provided on normal Bank terms; however, the Bank could offer such terms as necessary to match foreign competition. An initial authorization and appropriation of $500 million in capital should be provided for the program.

Private financing of U.S. exports will be assisted by changes incorporated in the International Banking Act of 1978 which liberalize usage of Edge Act Corporations for export financing. The Federal Reserve Board should promptly issue revised regulations putting the new Edge provisions into effect, and the Commerce Department together with the Treasury Department and the Federal Reserve Board should launch a program to educate U.S. businesses in the formation and use of Edge corporations to finance exports.

NEGOTIATING REDUCTIONS IN FOREIGN BARRIERS TO U.S. EXPORTS

The export implications of the trade agreements negotiated at Geneva should be reviewed thoroughly by the Congress. The Subcommittee on International Finance will hold hearings on the agreements later this year.

Many of the non-tariff barriers which thwart U.S. exports will not be removed automatically by adoption of the trade agreements and the accompanying codes of behavior. A continuing effort to compel implementation of the codes will be required, and many disputes will arise which can only be resolved through bilateral negotiation. Congress should give particular attention to the mechanisms for implementing the trade agreements and insuring compliance with the codes.

Agriculture is the sector which suffers most from foreign non-tariff barriers and has the greatest long-term promise for U.S. export growth. The United States Government should increase its pressure on foreign governments to admit U.S. agricultural products, if necessary, by linking U.S. action on manufactured goods imports to foreign actions affecting U.S. agricultural exports.

Congress should re-examine agricultural policy to consider replacing a system of price supports and set-asides which pays farmers not to produce with a system of target prices and cash payments which encourages food production, holds down food prices, and stimulates agricultural exports. Meat is the most efficient means for the United States to provide protein to the rest of the world. Grain-fed meat exports would benefit from lower feed costs under a target-price system, and so would U.S. consumers.

The Commodity Credit Corporation should be authorized and directed to serve as U.S. agent in grain sales to non-market economies.

CCC could match the deals arranged by the Canadian and Australian wheat boards.

When the Tokyo Round of trade negotiations is finally concluded, it will be time for another. The Tokyo Round negotiations open the doors to a series of new negotiations. Non-GATT members have trade barriers, too, which should be tackled in multilateral negotiations. Special trade facilitation committees may be needed to clear trade complaints arising under the proposed GATT codes. U.S. export incentives have a vital role both in helping U.S. industry and agriculture to fulfill the promise of the MTN package, and in insuring that other countries keep their part of the promise.

Congress should adopt a package of export-stimulating measures to accompany the trade agreements. United States producers should be given maximum encouragement to exploit the export opportunities expected to result from the reduction of tariff and non-tariff barriers.

REDUCING U.S. GOVERNMENT DISINCENTIVES TO EXPORTS

Exporters assert that the biggest incentive the United States Government could provide to exports would be to reduce the many export restrictions and disincentives it imposes. U.S. exporters face export controls, anti-trust, anti-bribery, human rights, environmental review and other restrictions not faced by their competitors. Congress should resist the impulse to restrict exports to countries whose internal or external policies do not meet U.S. standards and objectives, when restrictions would prove ineffective.

Testimony received by the Banking Committee suggested that unilateral efforts by the United States to exert economic leverage on foreign governments through export restrictions have generally been unsuccessful.[26] In many cases other countries have captured the export business and it is questionable whether U.S. foreign policy objectives have been advanced.

Congress should review the statutory and regulatory restrictions on U.S. exports to determine whether such restrictions accomplish purposes outweighing their economic cost. In many cases it may prove possible to design alternative approaches which serve U.S. moral and foreign policy concerns without sacrificing market opportunities. A place to begin is with revision in 1979 of the Export Administration Act.

Delays in export licensing decisions pursuant to the Act are a significant cause of U.S. export loss. Exporters should be informed of the specific reasons for license delays or rejections. Because U.S. licensing policy is often unclear, foreign purchasers come to regard the U.S. as an unreliable supplier. In areas of rapidly expanding technology, the control levels should be revised more frequently. Too often the Commerce Department responds to a rapidly evolving state of the art around the world only when deluged by license applications which should not have been required in the first place. If the Executive departments will not devise a more efficient way to provide essential monitoring and control without excessive disruption of U.S. exports, Congress must.

The restrictions in the Trade Act of 1974 and the Export-Import Bank Act on granting nondiscriminatory trade treatment and credits to communist countries should be amended to permit expanded trade

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[26] See hearings on the *Use of Export Credits and Controls for Foreign Policy Purposes*, Committee on Banking, Housing and Urban Affairs, October 10 and 11, 1978.

and credits subject to periodic review by Congress and the President of relations with such countries.

The President's Executive Order requiring environmental reviews of many U.S. exports threatens to discourage exports without encouraging environmental protection. Regulations to be issued pursuant to the executive order should be subject to careful public scrutiny as provided in the Administrative Procedure Act. Agencies should pursue international efforts to encourage environmental protection to the maximum extent feasible rather than imposing unilateral environmental reviews. The President should revise his order to authorize U.S. Government review of the environmental effect in a foreign country of U.S. exports only upon the request of the foreign government, and to require consideration of foreign availability and the reputation of the U.S. as a supplier before proceeding with any environmental review pursuant to the order.

INTERNATIONAL FINANCE AND U.S. EXPORTS

Competitiveness will avail the United States little if the world is insolvent. The problem of financing economic growth throughout the world is beyond the scope of this study, but not beyond the scope of this subcommittee's interest. Global institutions of finance and trade are needed as urgently as a U.S. export policy. The Bretton Woods system has been seriously undermined, but the world awaits U.S. leadership to develop a replacement. The world monetary order should be expanded, as well as stabilized. In addition, the United States should lead in the creation of new global institutions to deal with the resource problems of an interdependent world and the economic development of the poorest countries.

These objectives intertwine. Developing countries today purchase more of the U.S. capital goods than do Europe, Japan and the East Bloc combined. These countries also represent our fastest growing export markets. An increased commitment to development assistance and international scientific and technological cooperation should be made, not out of a sense of short-term political expediency, but with the conviction that these directions unchallengeably advance the long-term economic and political interests of the United States. The potential is clear, but the U.S. response is not. We must act before these goals are preempted by policies too narrowly conceived to serve an interdependent world.

ADDITIONAL VIEWS OF SENATORS WILLIAMS, CRANSTON AND TSONGAS

We want to commend Senator Stevenson, chairman of the Subcommittee on International Finance, for the thorough and probing hearings he held last year on U.S. export policy. The subcommittee's report on these hearings will provide invaluable guidelines as the Congress explores ways to improve U.S. export performance.

While we generally concur with the findings detailed in the report, we cannot endorse all of the recommendations contained therein.

In particular, we do not agree with the recommendation that the provisions of the Trade Act of 1974 applicable to the granting of nondiscriminatory trade treatment to communist countries be amended. We believe that sufficient authority to expand trade and credits with nonmarket economy countries exists under the terms of section 402, also known as the Jackson-Vanik amendment. The President can, by exercising his waiver authority when necessary and advisable, achieve those objectives in accordance with the provisions of current law and with the concurrence of Congress. In our judgment, it would be both unwise and unnecessary to recommend at this time that the law be altered.

ADDITIONAL VIEWS OF SENATOR HEINZ

This report represents the substance of 11 days of hearings and submissions from both the Government and the private sector on export policy problems. As such it is both comprehensive and definitive on a subject which has increasingly become a focus of policy debate since the hearings were held last spring. As the monthly trade deficit figures were announced last year, each grimmer than the last, and as the dollar continued its dramatic decline, the Nation as a whole began to realize what members of this subcommittee have been saying for some time—that these events have had a serious adverse impact on our economy, most notably contributing significantly to inflation, and that one sensible means of dealing with the deficit is to increase our exports.

With some notable exceptions, the value and potential of exports have been unappreciated by many American businessmen historically used to relying solely on domestic sales. Exports represent a smaller proportion of our total economic activity than other industrialized countries, but an improvement in that performance inevitably rests upon convincing businessmen that the export market is lucrative from an economic point of view and viable from a practical point of view. That is, we must convince our businessmen that they can make money exporting and that the costs—both economic and bureaucratic—will not outweight the benefits.

Realizing this change will depend on direct contact with individual entrepreneurs in order to make a persuasive case. Such persuasion, however, will be helped immeasurably by the substantive recommendations in this report. While I cannot endorse all the recommendations at this time, on the whole I believe they will do much to improve the exporting climate in the United States and put exports in their rightful place in our economy.

Of particular importance among the report's recommendations are the reorganization of the executive branch into a Department of Trade (whether it would be a Department of International Trade and Investment as Senator Roth conceived in his legislation, which I am cosponsoring, or some other approach is a question for separate study) and the streamlining of the bureaucracy, particularly our export licensing procedures, so that our own controls serve real policy purposes rather than simply tie our hands with red tape.

Interesting businessmen in exporting means both making it easy for them to get involved—as reorganization and streamlining could do—but also making it profitable for them. This means more effective incentives, through the Export-Import Bank so we can compete financially with other nations, and through tax incentives. Though a case can be made that DISC has been of only marginal help to smaller businesses and that most of the benefits have gone to larger established firms, it nonetheless is the best thing we have at the present time and thus has both a symbolic and substantive significance. Eliminating

DISC would be a clear signal to our exporting community that their activities really do not have a high priority in our economy. We can ill afford to send that signal at this time, although I am told that administration dislike of DISC has already created uncertainties about its future and therefore some reluctance to begin to use it. I do, however, agree with this report's conclusion that we can do better, and I urge prompt study both of proposals for a value added tax and the use of tax deferral by export sales subsidiaries.

The recommendations in this report add up to substantially more than the President's proposals, which have been accurately described as "modest." The Carter administration is clearly committed in principle to expanded export activity, but the limited nature of the President's recommendations show his reluctance to take the necessary practical steps, and pay the necessary costs, to achieve the objectives. It is a fact that incentives are going to cost money, that reorganization will intrude on bureaucratic fiefdoms, that streamlining our export licensing procedures will impinge upon other policy objectives, that more aggressive competition for export sales through more extensive Export-Import Bank activity may irritate our trading partners (largely the same ones, incidentally, that are dumping subsidized products in this country).

An effective export promotion policy necessitates a recognition of these facts and a commitment to bear their costs. Senator Stevenson and I, among others, are prepared for that and believe the overall benefits will outweigh these costs. I am concerned that the administration may believe it can accomplish the same thing on the cheap—through half steps that don't significantly change existing policies and relationships. This report should make clear both the importance to our economy of achieving the goals we have all agreed on and the possibility of meeting them through half measures.

ADDITIONAL VIEW OF SENATOR KASSEBAUM

As I did not participate in the hearings or study leading to the preparation of this report, I feel it would be inappropriate for me to either endorse its recommendations or refrain from endorsement. However, I do note that the report contains suggestions which will require committee action and I certainly look forward to the challenge of findings ways to improve American trade policy, particularly as it relates to the export of agricultural products.

UNITED STATES SENATE,
Washington, D.C., April 11, 1979.

HON. ROBERT STRAUSS,
Special Representative for Trade Negotiations,
Washington, D.C.

DEAR BOB: Your letter of April 4 is reassuring with respect to the effect of the proposed export subsidies code on the competitive position of the United States. For the sake of further clarification, could you or your staff respond for the record to the following?

1. Would legislation to encourage formation of U.S. export trading companies which provided that trading company profits would be taxed only upon distribution to shareholders be permissible under GATT rules and the proposed subsidies code? An outline of provisions embodying this concept is attached for your review.

2. Would legislation which provided a tax credit to export trading company shareholders for any losses in the initial five years of operations, which would be recaptured as profits are earned, be permissible under GATT rules and the proposed subsidies code?

3. Would legislation which authorized a Federal government agency to make loans to export trading companies to finance start-up losses during the initial five years of operations be permissible?

4. Would enactment of S. 864, the Export Trade Association Act of 1979, a bill introduced by Senator Danforth and others, and referred to the Banking Committee, raise any difficulties under GATT or the subsidies code?

5. You noted in your letter that export financing consistent with the terms of the OECD Export Credit Arrangement is not prohibited by the subsidies code. Is export financing which is inconsistent with the OECD Export Credit Arrangement or outside the scope of the Arrangement prohibited?

6. Enclosed please find a copy of a May 1973 report prepared by the Department of Commerce which lists nontariff barriers to trade used by foreign countries. Please annotate the list to indicate with respect to each trade barrier whether the practice will be halted, modified, or left unchanged by the proposed MTN codes.

7. Enclosed please find a copy of part 3 of hearings on Export Policy held last year by the Subcommittee on International Finance, which includes at pages 143 through 201 an analysis of export subsidies offered by six major trading countries. Please indicate with respect to each subsidy whether the proposed subsidies code or other provisions of the MTN package will secure removal or modification of the subsidy.

I want to thank you and Ambassador McDonald for your generous assistance to the Subcommittee in its review of the export implications for the United States of the proposed agreements.

With best wishes,

Sincerely,

ADLAI E. STEVENSON.

THE WHITE HOUSE,
Washington, D.C., June 29, 1979.

HON. ADLAI E. STEVENSON,
U.S. Senate, Washington, D.C.

DEAR SENATOR STEVENSON: I am pleased to supplement my earlier statements to you and those of my colleagues on the possible impact of the MTN in the promotion of U.S. exports. I cannot presume to answer all the detailed aspects of your questions. To do this, I think it may be useful to arrange a meeting between your staff and Dick Rivers, our general counsel, who was responsible for negotiating the subsidy code.

With respect to the tax treatment of export trading companies envisioned in your letter, a number of subsidy code provisions are relevant. I have enclosed a copy of the code for your reference. First, the subsidy code deals with subsidies, especially export subsidies, granted on products. Any subsidy found to exist, therefore, must be related to the sales or distribution of a product. Second, the code does not undertake to define the concept of a subsidy or export subsidy. Instead it relies on illustrations, an approach that will require study, discussion and case law to supplement. As a start, the annex to the code contains an illustrative list of export subsidies. It is this section that provides guidance on the types of practices that are or could be subject to the code's discipline.

One of the illustrative examples of export subsidies in paragraph (e) of the annex is as follows: "The full or partial exemption, remission, or deferral specifically related to exports, of direct taxes . . . paid or payable by industrial or commercial enterprises." Thus, in your examples, altering the point of taxation (i.e. having company profits taxed upon distribution to shareholders) would not necessarily constitute an export subsidy.

Specific tax exemptions related to exports, however, could be regarded as prohibited subsidies. With respect to tax credit for losses, to the extent that such credits are considered a tax deferral to be recaptured as profits are earned, it may be considered an export subsidy. Nonetheless, a footnote "2" to section (e) states that tax deferrals ". . . need not amount to an export subsidy where, for example, appropriate interest charges are collected." The final answer to whether such a mechanism would be considered an export subsidy would depend on all its specific elements.

As a rule, questions of organization for export, i.e. through export associations, would not be considered export subsidies under the subsidies code.

The availability of government funds is not necessarily regarded as a subsidy. While there is no specific section of the agreement that addresses your point, section (k) of the annex may be indicative. This section notes that export credits provided by governments at "rates below those which they actually have to pay for the funds so employed or the payment by them of all or part of the costs incurred by exporters or financial institutions in obtaining credits. . . ." would be regarded as an export subsidy. The critical questions are the terms at which such funds are made available and the relationship of the funds to the exported product.

As section (k) of the annex indicates, if a signatory to the subsidy code is a party to the OECD Export Credit Arrangement, export credits provided ". . . in conformity with those provisions shall not be considered an export subsidy prohibited by this [subsidies] Agreement." If export credits are granted on merchandise that is not subject to the OECD Arrangement, then the general criteria of section (k) applies, in ascertaining whether a subsidy is involved, i.e., whether the credits are provided on terms more favorable than those available in the commercial market.

The various nontariff measures compiled by the Department of Commerce in 1973 provided an invaluable focus for the MTN. I wish I could say that all the NTMs contained in that list have been abolished or modified as a result of the MTN. That would be overstating the case.

In the early stages of the MTN, we considered approaching trading off NTM for NTM on a reciprocal basis, much like is done in the tariff field. Such an approach is filled with difficulties, not only of a political nature, but also from a practical point of view. How can you quantify the value of an NTM concession? What would the United States have given in return? We traditionally regard ourselves as not having many NTMs that affect trade. Thus, when it came to paying for foreign concessions our pockets would be empty.

In order to maximize our negotiating leverage, we approached various NTM fields through general negotiations. As you can see by the Commerce list, we've tackled all of the significant NTM categories. The success of the negotiations depends upon all signatories to the codes undertaking the necessary action to remove or mitigate the trade effects of the NTMs or being prepared to face international confrontation and compromise, including possible compensation or retaliation. The various codes contain new guidelines and principles by which such NTM activity and its trade impact can be gauged. This is admittedly not a perfect solution, but it is a significant step forward from the current state of international rules that permitted the growth of the massive amount of NTMs enumerated in the list. I cannot comment on each of the items in the Commerce list since some entries are general in nature while others refer to practices that may have to be modified.

Finally, country actions to remove or modify the various export subsidy practices contained in the Export Policy hearings will depend on a number of factors, not the least of which is domestic ratification of the agreement. Some measures may clearly correspond to those contained in the annex to the subsidies code, while others may fall in a grey area. Ultimately, as in any international agreement, the country can exercise its sovereign right to maintain a practice that may be in clear violation of the code. But it has to be willing to suffer the international consequences, including the withdrawal of the application of the code's provisions to its exports.

Sincerely yours,

ROBERT S. STRAUSS.

Senator STEVENSON. Our next witness is Mr. Frank Weil, the Assistant Secretary of Commerce for Industry and Trade. And the Government has no more stalwart champion of exports than Mr. Weil.

STATEMENT OF FRANK A. WEIL, ASSISTANT SECRETARY OF COMMERCE FOR INDUSTRY AND TRADE, ACCOMPANIED BY W. DOUGLAS NEWKIRK

Mr. WEIL. Mr. Chairman, thank you for those pleasant words. I apologize for the condition of my voice. I have a cold.

It is a pleasure to be back before you to address the questions you have raised regarding the export implications of the MTN agreements and related issues.

Specifically, I would like to cover the following points per your request:

The export opportunities created or enhanced by the MTN;

The impact of the subsidies/countervail code on U.S. export policy;

The effect of the code on U.S. and foreign subsidy practices;

The recent Congressional Budget Office report on the MTN and U. S. trade policy; and

The Jones' Task Force Report on U.S.-Japan trade.

The questions the subcommittee has raised are crucial ones. We are becoming increasingly concerned, and rightfully so, with our trade imbalance. We are seeking ways to strengthen our economy, slow inflation and contract our trade deficit.

I believe the solution to these problems is more trade, not less trade. We need to expand our participation in the world economy and push export development as the best solution to declining economic welfare.

I am encouraged to see that this subcommitee has recognized in its report our recent efforts to develop a coordinated and supportive U.S. Government export policy. The subcommittee's report is an excellent effort, precisely because it supports the need for Government-wide cooperation in an export expansion drive.

The need today is for an expanding mercantilism. Faster export growth through a reawakening of U.S. aggressiveness and greater foreign market opportunities, is our answer. To help U.S. exporters, the Government must provide:

More open access to foreign markets;

More equitable and visible trading rules; and

A fully competitive effort to take advantage of those rules.

The MTN is a move in the right direction toward expanding our competitiveness. The agreements that Special Trade Representative Robert Strauss has negotiated—and he told me this morning he heard last night that the European Community Council of Ministers had agreed in principle to the negotiations—could expand and enhance our export opportunities.

The efforts undertaken in Geneva and the work being done in the United States-Japan Trade Facilitation Committee are important first steps. So is our initiation of the National Export Policy.

Now and in the months to come, the Congress and the executive branch will be assessing the impact of the MTN and related issues on U.S. trade and trade policy.

I hope we will find that the results represent a positive commitment to increasing our economic strength.

Mr. Chairman, if you wish, I could summarize my prepared statement which I believe you have. This will leave us more time to respond to your questions.

Senator STEVENSON. Let's do so. The full statement will be entered in the record.

Mr. WEIL. The tariff agreements are certainly a step in the right direction. They reduce the level of tariffs in this round in a balanced way, which should have the effect of further reducing the price aspect of competitive trade.

This round, I think, is going to be remembered much more, however, for its nontariff measures. Therefore, if I might just pass quickly through the nontariff codes which, I gather from having been here a few minutes while Ambassador McDonald was testifying, you have been reviewing in some detail.

The Government procurement code is an important code.

And as our current negotiations with the Japanese have indicated, it is taken seriously by them. Either they will join it or they will not. But if they do, it should have the effect of opening for the United States more of the Japanese market than was open in the past in fields which are of importance to us. As Ambassador McDonald said, the greater degree of certainty that will come from this substantially more specific code can be greatly to our advantage. And since we have been relatively more open in this area than some of our trading partners, this should be, no matter what happens, more to our advantage than to our disadvantage.

The same applies to the standards code. And the custom valuation code.

In those cases the greater precision will make it more possible for American business to either directly proceed into foreign markets. Moreover, if they have problems similar to those which they have had in the past, through the consultative mechanism in the GATT that Ambassador McDonald referred to, they can get a more expeditious and perhaps even more effective hearing on overcoming those problems.

With respect to the subsidy-countervail code, I think that there are opportunities there which can benefit us.

We are in a world where our competitors have been using various forms of subsidies to a greater extent than we have. We will benefit by this new code only if we aggressively use it. Since some of the practices which this code would prohibit are used by our competitors, only if we are careful in our detailed analysis of what these subsidy practices are and are willing to complain about them will we gradually rid ourselves of unfair competition.

There is no question that at this point, in a general way, we are further behind the scrimmage line in the use of export-related subsidies than many of our trading competitors.

Since we have drawn a new line, a stricter line, a clearer line, it will be incumbent upon us through the use of the countervailing powers to work hard to cause our competitors to restrict those practices.

I do not need to mention anything with respect to DISC in detail. It's in my prepared testimony and Ambassador McDonald covered that, I think, very clearly.

The CBO report, in our opinion, reaches, generally speaking, the right conclusions—that the MTN results will be positive, if we take proper advantage of them.

The analysis obviously was made at a time when the facts were not altogether complete, and the analysis made no provisions for the exceptions from the tariff cuts.

I think the CBO report did not give as much attention to the nontariff measures as some of us would have preferred. And I think that the CBO report was looking more at the issue of protectionism, rather than increasing liberalization which is the intention of the codes. However, the basic conclusion of the report—that the MTN agreements in the main will be of benefit to the U.S. economy, provided we take advantage of them, is a valid conclusion.

Lastly, with respect to the Jones Task Force Report on United States-Japan Trade, we agree that there are still substantial barriers in Japan to U.S. trade. Some of those barriers are of an intangible nature; a residue of centuries of the Japanese point of view with respect to importation of foreign manufactured goods.

We continue to work on those problems. The Trade Facilitation Committee, which has been in existence now for a year-and-a-half, while it has not been a spectacular success, has, I think, served the American business man well, both in terms of specific cases, as well as in terms of the availability of a place to go with documented complaints.

The Japanese have been extremely cooperative with us in a number of promotional activities.

Those activities have to be looked upon as symbols rather than as specific measures to change the numbers of our bilateral trade.

For example, this fall the Japanese have made available to us a ship they have used for many years as a floating exhibit around the world.

This ship will visit 12 Japanese ports in 50 selling days. We estimate that somewhere between a half-million and a million Japanese consumers will be able to come on this ship and buy American consumer goods, including beef, at American prices. The importance of this is not the dollars involved, but the fact that a substantial number of Japanese consumers will see what they have been missing, because of their distribution system, and they will exert, hopefully, pressure on their own system to have greater and freer access to American goods.

I would have to say, Mr. Chairman, that our efforts in these past 2 years with respect to changes in the U.S. trade position have not yet shown significant results.

It's true that our trade balance began to turn somewhat in our favor in the middle of last year, and it's true that the trade numbers in February were heartening.

But only if we now proceed from the liberalization of the MTN, which is to our advantage, to taking steps to insure that we will be competitive, then I think we will have launched possibly an era of expanding mercantilism.

I would be very glad to respond to any of your questions.

[Complete statement follows:]

STATEMENT OF FRANK A. WEIL, ASSISTANT SECRETARY OF COMMERCE FOR INDUSTRY AND TRADE

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I am encouraged to see that this Subcommittee has recognized in its report our recent efforts to develop a coordinated and supportive U.S. Government export policy. The Subcommittee's report is an excellent effort, precisely because it supports the need for government-wide cooperation in an export expansion drive.

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a fully competitive effort to take advantage of those rules.

The MTN is a move in the right direction toward expanding our competitiveness. The agreements that STR Robert Strauss has negotiated should expand and enhance our export opportunities. The efforts undertaken in Geneva and work being done in the U.S.-Japan Trade Facilitation Committee are important first steps. So is our initiation of the National Export Policy.

Now and in the months to come, the Congress and the Executive Branch alike will be assessing the impact of the MTN and related issues on U.S. trade and trade policy. I believe we will find that the results represent a positive commitment to increasing our economic strength.

I. THE MTN AND U.S. EXPORT OPPORTUNITIES

The MTN agreements, covering tariff reductions, international codes of conduct on nontariff measures, and bilateral agreements on specific trade problems, will increase market access and will improve the structure and discipline of the international trading system. Both results will mean greater export opportunities for U.S. businesses.

Tariff negotiations with our major trading partners are substantially complete. The agreements concluded, particularly with Japan and Canada, represent a high degree of trade liberalization for agricultural and industrial products and result in an average depth of cut vis-a-vis the United States for industrial products of approximately 60 percent from Japan and 40 percent from Canada. The reductions we have negotiated should be especially advantageous for such U.S. manufacturing sectors as computers, electronic components, scientific and controlling instruments and construction equipment. In the post-MTN period, exporters of computers, for example, should enjoy tariffs averaging 60 percent lower than current rates in their major export markets. For construction equipment, duties should be in the 4 percent to 10½ percent range, down an average of over 30 percent from presently bound rates.

Along with tariff reductions, a broad package of rules, or *multilateral codes,* on the use of nontariff measures (NTM's) are being negotiated. The improvements in the international trading structure which result from these agreements will provide a more advantageous environment for U.S. exporters.

The NTM codes of conduct negotiated are designed to limit the use of certain trade-distorting measures, including discriminatory government procurement practices, subsidies and standards. They are intended to render the use of other measures, such as customs valuation for tariff assessment purposes, discretionary import licensing and market disruption safeguards, more transparent, regularized and predictable.

The *government procurement code,* for example, will bring important elements of the central government procurement sector under international discipline for the first time, applying the key principles of national treatment and nondiscrimination among signatories. In so doing, it will allow U.S. suppliers the opportunity to compete for over $20 billion in contracts previously exempt from international competition.

In this context, regarding Japan's Nippon Telegraph and Telephone Public Corporation, we are continuing to push for coverage of this entity under code discipline. As you probably have read recently in the press the Japanese have not agreed to our request, but we have not given up our efforts.

The code on technical barrier to trade—*the standards code*—will provide an international mechanism through which specific industry complaints about foreign standards can be challenged. The provisions of the code will ensure that the preparation, adoption and application of technical standards and regulations will not hinder imports, including those from the United States.

The *Customs Valuation Code* will bring an end to the foreign practice of arbitrarily uplifting the dutiable value of imports. These arbitrary uplifts have been levied on U.S. exports worth, conservatively speaking, hundreds of millions of U.S. dollars.

In some cases, U.S. exporters have had their goods valued at up to twice the price they paid for them—a 100-percent uplift.

In the MTN, we have also negotiated *bilateral agreements* on NTMs, taking into account extensive private sector advice on trade-distorting practices. The agreements, which cover numerous products and deal with diverse measures not provided for in multilateral codes, should enhance export opportunities for particular industry sectors.

The new codes, coupled with bilaterally negotiated tariff cuts and agreements on particular trade problems, will be a very positive factor in U.S. export performance. We do not expect a sudden jump in trade volume, because the results of the MTN will be phased in over several years. The long-term benefits, however, will be great.

II. SUBSIDY/COUNTERVAIL CODE AND U.S. EXPORT POLICY

The MTN Code on Subsidies and Countervailing Measures significantly strengthens the existing provisons of the General Agreement on Tariffs and Trade (GATT) relating to the use of government subsidies that have an adverse impact on international trade.

Under the GATT, seventeen Contracting Parties, including the United States, agreed that they would not make use of export subsidies in their attempts to stimulate exports of manufactured products when such subsidization would lead to overseas market prices below those charged for similar goods sold domestically, the so-called "bi-level pricing" criterion. A list of illustrative export subsidy practices was developed in 1960.

The new MTN Agreement improves upon the GATT rules by eliminating the bi-level pricing criterion; enlarging the product coverage through the inclusion of primary mineral products; and substantially expanding and updating the illustrative listing of prohibited subsidy practices.

The practical effect of the international rules on the use of subsidies will be enhanced through the new Code's dispute settlement mechanism, which will permit an effective and expeditious enforcement of signatory countries' rights and obligations. In addition, we expect that a greater number of countries will be bound by the new rules, including a number of key developing countries.

III. THE EFFECT OF THE SUBSIDIES CODE ON U.S. AND FOREIGN SUBSIDIES

Recently, it has been alleged that the subsidies code will shelter the existing export measures of other countries while prohibiting the United States from adopting new programs designed to meet foreign competition.

That is not accurate. Rather than sheltering foreign export subsidies, the Code will explicitly provide the grounds for the elimination of many of these practices. By way of example, Ireland now exempts income derived from manufactured exports from corporate income tax. This system of subsidizing exports will be withdrawn by January 1980.

Another case in point is Brazil, where that country's adherence to the Code will entail the elimination of its practice of overrebating indirect taxes on exported products.

Finally, the Code attacks as export subsidies the European export inflation insurance programs and export financing granted outside the terms of international agreements on export credits.

With regard to U.S. programs, the Code's provisions will not prevent foreign governments from complaining about the DISC in international fora. Other countries have alleged that the DISC program amounts to an export subsidy under the

GATT, and I do not doubt that they will continue to attack the program. However, it is important to note that our adherence to the Code will not require the United States to eliminate DISC as a part of our MTN Agreement. Our only commitment in this regard is that we are prepared to examine methods through which the operation of the DISC program can be brought into full conformity with the Code within a reasonable period of time.

As to the adoption of new U.S. programs to meet foreign competition, the Administration is of the view that the introduction of export subsidies would not be appropriate. Overall, we believe that, within the parameters established by the Code, there is ample room to enable the development of new programs that will encourage American firms to export without running afoul of our international obligations.

IV. CBO REVIEW OF THE MTN

The major thrust of the Congressional Budget Office (CBO) study is that, in macro-economic terms, the overall results of the MTN will be positive for the United States. While, on an industry sector basis, there will be gainers and losers, the study concludes that the former should outweigh the latter. The CBO report points up many potential benefits of the MTN, benefits that we believe have been achieved and further enhanced through the negotiating process. These include:

Higher efficiency in production and lower costs for inputs.

Lower prices for consumers.

New job opportunities, particularly in the exporting sector.

International trading rules to prevent a return to more restrictive trade practices.

International rules on government involvement in trade to ensure that practices, such as government subsidies and procurement, are more open and fair.

While the report has many merits, it also contains some shortcomings. These are largely due to the unavailability of current data with which the CBO could determine the effects of the MTN. The findings and assessments do not therefore necessarily reflect expected final results of the negotiations.

For example, the outside studies on which the CBO report is based analyze theoretical MTN results from straight linear tariff reductions of either 50 or 60 percent. They make no provision for tariff offer exceptions for sensitive industries.

Based on these older studies, the CBO forecasts some regional employment dislocations. The report finds that the workers most likely to suffer from trade liberalization will be those least mobile, in other words, the American worker most currently disadvantaged.

These theoretical, negative effects of the MTN have been, in turn, highlighted in many recent press reviews.

In contrast, the United States negotiated tariff reductions with exceptions for products in sensitive industries. Original exceptions and an extensive series of further modifications were made on the basis of close consultations with:

The private sector advisory committees, established under the provisions of the 1974 Trade Act;

Members of Congress and their staffs; and

Officials of the Administration.

The final U.S. tariff cut in the MTN will be only slightly more than half the theoretical levels assumed in the studies used by the CBO, that is, 30-35 percent. Significantly lesser cuts were made on textiles, leather and leather products, tires and rubber products, steel products, automotive equipment, communications equipment and consumer electronics.

Another weakness is the insufficient attention paid in the study to the trade liberalizing effects of MTN agreements. Though more difficult to quantify than the effects of tariff reductions, the benefits of the codes to the United States will be significantly longer term and more far-reaching.

One last shortcoming, albeit a relatively minor one, is that the study unduly stresses that a primary benefit of the trade agreements will be the preservation, and not further liberalization, of "a liberal system of world trade." That is, the report tends to view the MTN as a means of stemming the tide of encroaching protectionism rather than as a vehicle for achieving positive gains for U.S. and world trade.

Despite these shortcomings, the CBO findings on the MTN are fair and very supportive. The problem areas highlighted by the CBO are, in large measure, the ones our negotiators took into account in their selective approach to U.S. tariff cuts.

I believe that a CBO study of the final MTN results will reflect the care and close attention given to the sensitive interests they describe in this report.

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V. JONES TASK FORCE REPORT ON U.S.-JAPAN TRADE

We agree with the conclusion of the Jones' "Task Force Report on United States-Japan Trade" that there are still significant barriers to imports into Japan. We further agree with the Report's recommendation that, as a mechanism for reducing these barriers, the Joint U.S.-Japan Trade Facilitation Committee, or TFC, should be continued. Let me summarize briefly the TFC, its work to date, and what we see as its role in the near future.

The TFC was established in September 1977 by Secretary Kreps and the Japanese Minister of International Trade and Industry as a cooperative effort to increase Japanese imports, particularly imports of U.S. manufactures. Its major activities are the bringing together of Japanese buyers and American sellers and the resolution of specific market access problems faced by American sellers.

TFC-sponsored activities to bring Japanese buyers and American sellers together are best exemplified by the 90-member Japan Import Promotion Mission to the United States of March 1978 and the 137-member U.S. Export Development Missions to Japan last October.

The Japanese have also offered us the use of a floating fair ship, the "Skin Sakura Maru", for exhibiting U.S. goods in Japan. We are now working with the Japanese Government and the U.S. consumer goods industry to use that ship as a floating trade promotion event that will call at 12 major Japanese ports in late 1979. We anticipate that, during its travels, the ship will reach a million Japanese consumers who can then put pressure on their government to increase purchases of U.S. consumer goods.

As regards the TFC's work to remove obstacles to the Japanese market that have been encountered by U.S. suppliers, 12 of the 18 cases submitted to the Japanese side of the TFC have been favorably resolved, while the balance are pending with the Japanese Government. Several other cases are with our Embassy in Tokyo being prepared for submission to the TFC, and about ten more are in the "pipeline" here in Washington.

The TFC's work has also focused public attention on the issue of Nippon Telegraph and Telephone, or NTT, procurement practices. Problems involving specific NTT practices were raised initially in connection with a complaint by an American company. More general problems were raised subsequently in sub-Cabinet talks last year. During my meetings in Japan last October, the Japanese press brought the NTT procurement issue into public view and focused wide attention on the need to subject NTT purchasing practices to the MTN's Government Procurement Code.

As the Task Force Report correctly indicates, the results of our efforts to resolve cases involving market access impediments have been somewhat uneven. Most of the twelve cases resolved through the TFC process were individual company complaints involving relatively small amounts of U.S. exports.

In our opinion, the Japanese Government has not been as responsive as we had hoped it would be in those market access cases where the relief sought would remove obstacles to the exports of products of an entire U.S. industry. For example, in the case involving severe import restrictions on cigarettes which was raised in February 1978, the Japanese did not agree to consultations until August and have yet to come up with meaningful concessions.

As the U.S. Co-Chairman of the TFC, I frequently meet with my Japanese counterpart for review and discussion of outstanding cases. We met four times last year and plan to meet again April 18 in Washington. At that meeting we shall be looking toward expediting progress on these outstanding cases.

Mr. Chairman, if you or members of your Subcommittee would like to attend that meeting, you would be most welcome.

I believe that we have made a good beginning in utilizing the TFC to overcome Japanese market access problems encountered by U.S. exporters and in otherwise expanding our exports to Japan. In the future, we expect to present to the TFC for resolution an increasing number of cases where the "pay-off" in trade terms could be substantial. The TFC may, through the process of reviewing concrete problems raised by American firms, be useful as a means for testing Japan's implementation of agreements concluded in the MTN.

It is important that the TFC be perceived by the American business community as a place where its export problems vis-a-vis Japan can be dealt with promptly and effectively. If the TFC is not so perceived, I'm afraid U.S. exporters will continue to be skeptical of the Japanese Government's readiness to facilitate imports and may not therefore be willing to make the effort needed to be successful.

CONCLUSION

Our efforts to date to improve market access and trading opportunities for U.S. suppliers have been good ones. Ambassador Strauss should be congratulated on the excellent job he has done in the MTN to reduce foreign tariffs and develop fairer trading rules.

All indications are that we are heading in the right direction. We can not stand still, however, and point to our accomplishments without planning the next steps.

By placing trade issues on the national agenda, the President has given us the incentive to pursue policies that will improve our trade performance. Over the longer term, faster export growth is the only way that the U.S. trade deficit can be reduced permanently without damaging the world economy.

Senator STEVENSON. Thank you, Mr. Weil. I think you have put your finger on the central question, which is who will benefit from the reduction of these tariffs, and especially the nontariff barriers, if, with growth rates declining in the world, partly as a result of increasing energy prices, other nations redouble their efforts to produce and to sell. They may be the ones who gain, unless, as you suggest, there is a new mercantilism and new recognition in the United States of the global dimension of the marketplace.

Many economists, some within this administration, still think that all we need are reduction of barriers and a devalued dollar and higher growth rates abroad to right the trade deficit.

In fact, they point to the figures you just pointed to as evidence that this is going to happen.

Do you agree?

Mr. WEIL. No, I do not, for a number of reasons. With respect to the dollar, I suppose there is a point at which the dollar could adjust to compensate for our deficiencies in trade.

But the cost to us in other areas in which the dollar affects our lives would be, in my opinion, not acceptable. The combination of the fact that the costs of a devalued dollar are too great in other areas; to wit, the cost of imported energy; and the implications of a devalued dollar on the rest of our economic process; and the fact we are living in a world in which price is increasingly a less important part of the whole purchasing process; all suggest, in my opinion, that we cannot and should not place excessive reliance upon adjustment in the value of the dollar.

I do not mean to suggest that it is not a substantial part of the process. It has been. There is no question that the change in the value of the dollar has been materially responsible for some of the changes in our trade balance over the past few years.

But I think that the curbing or our inflation rate is important because if we cannot control that and rely on the dollar, the dollar will have to adjust downwards to compensate for our continuing inflation.

I think excessive reliance on the growth rates of our trading partners would also be damaging because our trading partners are to begin with much more oriented toward exporting because of their historic dependence upon foreign markets. They are in a better position today than we are to take advantage of liberalized trade rules. If they increase their growth rates, they will increase their production. They will have to sell it somewhere. We may find they are also selling more competitively against us in foreign markets as well as our own markets.

For that reason, I think we have to recognize that even though 85 percent of our economic process is still within our continental 48 States—not to leave out in importance the State of Hawaii and State of Alaska—as distinct from Japan's 60 percent and Germany's 40 percent. Those countries know of their dependence on foreign markets. We as a people do not.

Because of that, we should expect them to be much more aggressive users of these new liberalized trade agreements. That is why some of the ideas in the recent report of the subcommittee are vital to our success in taking proper advantage of the MTN.

Senator STEVENSON. And the dollar doesn't depreciate or hasn't significantly against all currencies?

Mr. WEIL. Correct.

Senator STEVENSON. Including the currencies of some countries that are becoming significant competitors. Do you see any adverse consequences from these codes for the mercantilism of which you speak? What are the disadvantages? It will knock out DISC.

Mr. WEIL. I do not agree. As Ambassador McDonald pointed out, the DISC has been preserved.

Senator STEVENSON. I beg your pardon, you are right. DISC will be grandfathered. I want to correct myself. Are there any other disadvantages, though?

Mr. WEIL. Well, in a utopian world, there is no question that these codes are to our advantage. The only risk that I see, for example, in the subsidies code, is whether or not we will be successful, even if we are aggressive in policing that code, in causing the dissipation of the practices of our trading partners.

As I said earlier, they are ahead of us in using various forms of export subsidies. The GATT mechanism is one of those global legal mechanisms which works only in the court of public opinion.

Ambassador McDonald made a very important distinction: in a bilateral demarche when we have a complaint, we say this is against our interests; and they say, well, yes, but the reverse is against our interest, and we have a lot of conversations and very little happens; in a multilateral forum in which other countries judge us perhaps we might make more progress in advancing our national concerns.

I hope we will make it very clear—that the Congress will make it clear—that these rules are to our advantage if we are in a position to aggressively pursue them. We will have the power under the arrangements to do that.

But in the past, our willingness to retaliate through various methods has not been as aggressively pursued as might be necessary to dampen other countries' practices.

Senator STEVENSON. How can the Congress make what clear? I didn't understand your suggestion for the Congress. What is it that the Congress should make clear?

Mr. WEIL. I think the Congress—and I would expect this to happen, in any event—can help the process by making clear that, by adopting this code, we should aggressively use it. Putting it on the books, as Ambassador McDonald pointed out, by and of itself, will be of little advantage to us.

And, as Ambassador McDonald pointed out, historically, we have had only flurries of interest in trade negotiations during periods of deficit. In between, we go off to other grander subjects.

That may change. Trade may become a subject of front-burner interest on a regular basis for the rest of the century, but historically, trade has been a much more important subject to our global competitors than it has been with us.

If we go to sleep after the Tokyo Round and assume these rules by themselves are going to make things better, they will not.

Senator STEVENSON. If I read you accurately, you are saying two things. We have to use the codes. That requires a new mercantilism. And you may also be saying that these codes will require us to see to it that their violations are disciplined.

On the first point, if I am right, the Congress is beginning, I think, to see the need for an export strategy. This subcommittee does. You concede as much. And you also say that you are encouraged to see that this subcommittee has recognized in its report our recent efforts to develop a coordinated and supportive U.S. Government export policy.

I certainly recognize your efforts. The Congress recognizes your efforts and Secretary Kreps' efforts. But I still don't recognize the efforts of this administration. Where is its export strategy? How would it have the Congress make use of these codes?

Don't you think that just to get the trade agreement through the Congress, it would be good insurance, if nothing else, to have a strong export policy to assure us that we will take advantage of the opportunity that the codes create?

We still haven't got recommendations for reform of the Export Administration Act, which expires this year. We have been trying to get some recommendations on it since early last fall. So the only efforts I am aware of to make use of these codes are yours. And I don't denigrate those. In fact, I applaud them, as well as the efforts of this subcommittee and other agencies of the Congress.

When are we going to get an export policy from this administration?

Mr. WEIL. Obviously, Mr. Chairman, there are differing views as to what constitutes an export policy, and what will work along side of the MTN. I have to say that those different views have not been wholly resolved at this point. And I suppose that the debate that will take place in this hearing will cast some light, maybe even place a little heat under that subject.

I think that some believe that the MTN alone, coupled with a floating dollar and foreign growth rates, will solve our problems. Others feel that we need to do more.

In the 2 years I have been in Washington with the Government, I have come to have enormous respect for the kind of truth that emerges from the debating process. I am optimistic that somehow, between now and whenever the final vote is taken on the MTN package. There will be enough information on the table to make the MTN work.

Senator STEVENSON. Ambassador Strauss, Ambassador McDonald, they have done their duty. You are doing yours. The Congress wants to do its duty. And, so far, we haven't been given any recommendations from this administration on what it is. We are still waiting. The administration is not out of the woods. It could lose that trade agreement in the Congress. There is going to be a lot of skepticism that the administration can work something out with textiles, or with steel, or with shoes.

I remember what happened last year when I was managing the Eximbank legislation. A measure passed both Houses, swept through the Senate two to one, that would have undermined the trade negotiations at Geneva. It could happen again.

That trade deficit hasn't gotten much better than last year; the dollar hasn't recovered. It has stabilized a little. Oil prices are going up. Industries are still suffering from foreign competition. Still there isn't an export strategy from this administration to accompany that trade agreement and to convince ourselves we will move ahead and take advantage of the new opportunity.

I see this also in my Subcommittee on Science, Technology and Space. With cheap labor gone, cheap raw materials gone, cheap fuel gone, cheap money gone, what have we got left except food? Now even the competitive edge in industrial innovation, technology intensive products is going. The Japanese are making larger contributions for research and technology than we are.

Here is an advertisement from Japan for the world's most advanced computer memory. The problem goes beyond export strategy right down to the competitiveness of the United States. Our rate of productivity growth is now the lowest of all the industrialized nations.

We can bring down all these barriers and everybody else can walk in and take advantage of the new markets. We will be left out, and what if they move into ours? Here we sit, waiting, still.

Mr. WEIL. Mr. Chairman, you mentioned earlier that Ambassador Strauss and Ambassador McDonald, both, have done their duty. And I think they have done a spectacular job negotiating in a very negative environment.

But, happily, I think they feel they would have done enough if all they did now was deliver the package. It would be akin to putting the baby on the doorstep and walking away.

As Ambassador McDonald said this morning—and I have heard Ambassador Strauss say it on other occasions as well as Ambassador Wolff—they have said, much as I have said, that we have got to accompany the MTN with adequate support. I think they will not feel they have done their duty until they participate in that process.

Up to this point, they have been primarily concerned with the negotiation. But I am heartened to see them turning their concerns to the collateral side. Even if the MTN legislation could pass alone today—and there are many who believe that is possible—I think that Ambassador Strauss and his colleagues share the view that it might not prove in the longer run to be to our advantage.

Therefore, even though that package according to the 1974 Trade Act has to go up alone and be voted up or down. It is incumbent upon those of us that are working on this subject to insure that it not go up naked and alone.

Senator STEVENSON. Do you have any idea when we will get the export side from the administration?

Mr. WEIL. Some time between now and the vote on the MTN package.

Senator STEVENSON. Well, better sooner than later. We are not going to wait.

Let me make sure that I heard you correctly. You don't see anything in these codes that will handicap us in our efforts to develop that export strategy, the new mercantilism of which you speak? There aren't going to be any prohibitions in here that will affect Exim, or CCC, or the trading companies I would like to see created, or other such efforts to make our exports more competitive in the world marketplace?

Mr. WEIL. If we wanted, which we do not, to have explicit export subsidies, this would be an inhibition. It has been my view, and has been consistently my view for the past 2 years, that this is not our main failing.

If we are harboring under the surface a lingering desire to establish explicit export subsidies, then this subsidy code is a mistake. We in the administration, and I would include myself vigorously among them, do not have such ambitions.

Other than that, I think that these codes do not contain any, that I am aware of, seeds of inhibitions or prohibitions that would prevent us from doing all the things we need to do.

For example, you mention the trading companies. I am not aware of anything in these codes that would prevent us from encouraging trading companies. I should add, however, that trading companies in Japan and Europe are institutions that have evolved over long periods of time. Much as we would like to see such institutions created in this country, they must evolve over time. They cannot be created by a sudden wave of the wand.

I think there are some major firms seriously beginning to think about it. I am aware of one major bank thinking about it. It is questionable whether the Fed will permit it. But I think other than the possibility that some people in this country might like to see us have explicit export subsidies, I do not see any inhibitions. I personally would not have any problem with that inhibition.

Senator STEVENSON. Do you think the LDC's are treated fairly by the codes from our standpoint? Have we made too many concessions to the LDC's, including the advanced LDC's?

Mr. WEIL. I don't think so. I think we have the mechanisms available to deal bilaterally with the advanced LDC's and some of their special competencies. And, again, as Ambassador McDonald pointed out, it should be possible for us to keep under control the special problems and circumstances that come sometimes from these countries.

In fact, there is no significant distinction between the developed countries and less developed countries in the codes per se. We have made distinctions more on a bilateral basis than on a multilateral basis.

Senator STEVENSON. Well, maybe instead of saying we weren't going to wait to develop that export strategy, I should have said we will wait, to coin a phrase, until hell freezes over. But I don't think we will. We must get moving.

It would be helpful to have the benefit of the administration's advice across the board. I would like to get it on all the recommendations in our report including the Export Administration Act which we should be moving on soon.

Mr. WEIL. On the latter, I am going to testify on the other side of the Hill this afternoon on that. I hope that by the time I testify, I will have something more on that. We will have an administration bill on the Export Administration Act. I think it will be responsive to some of the concerns I know you have on that subject. It is a busy time and a busy town, and the trade issues are not always first on the agenda.

Senator STEVENSON. I am sorry. I didn't see we had been joined by my colleague from Massachusetts, Senator Tsongas. Any questions?

Senator TSONGAS. I am just reading through the testimony, Mr. Chairman. I apologize for being late. We have conflicting committee assignments. I look forward to working with you in the future.

Senator STEVENSON. Thank you, Mr. Weil. I appreciate your testimony this morning and your continued efforts.

Mr. WEIL. Thank you.

Senator STEVENSON. Our next witness is Howard D. Samuel, Deputy Under Secretary for International Affairs, Department of Labor.

STATEMENT OF HOWARD D. SAMUEL, DEPUTY UNDER SECRETARY FOR INTERNATIONAL AFFAIRS, DEPARTMENT OF LABOR; ACCOMPANIED BY C. MICHAEL AHO, DIRECTOR, OFFICE OF FOREIGN ECONOMIC RESEARCH, BUREAU OF INTERNATIONAL AFFAIRS, DEPARTMENT OF LABOR

Mr. SAMUEL. Good morning.

Senator STEVENSON. Mr. Samuel, you are welcome to summarize your statement in which case I will enter the full statement in the record.

Please proceed.

Mr. SAMUEL. Thank you, Mr. Chairman, I will accept your offer.

Mr. Chairman, and members of the committee, you asked us particularly, of course, for our discussion of the effect of trade and of the MTN in particular on employment opportunities, and I will summarize my testimony in this area.

First of all, I hardly need to emphasize that trade in general is playing a much larger role in our economy now than it has in the past, and it probably will continue to play an increasing role in the future.

One of the ways of judging that is by looking at the number of manufacturing jobs related to exports. That figure, the number of manufacturing jobs related directly and indirectly to exports, we figure has risen from 1 out of 14 in 1964 to more than 1 in 8 by 1975, perhaps even higher by now.

We believe, although the final foreign-tariff offers are not yet available, that the industrial sectors in the United States which will benefit from trade liberalization and an expansion of trade are, in general, the same sectors in which the United States has traditionally had a strong comparative advantage.

They include: Aircraft, computers and electrical equipment and machinery.

For example, going to specific figures, the increase in exports of computers between 1964 and 1975 was responsible for an increase of slightly over 38,000 jobs directly and indirectly.

Exports were responsible for 19 percent of the jobs in the computer industry in 1964. By 1975, 37 percent of computer industry jobs were export related. In aircraft, the proportion rose from 20 to 35 percent.

In general though, it's obvious exports benefit our Nation in a number of ways. Nevertheless, the processes of trade generally clearly have a two-way effect, those in export industries benefit, those in industries impacted by imports may have to carry a fairly serious burden.

Of course, it's been our obligation through the MTN to do the best work we can to maximize the benefits, by expanding export opportunities, and to minimize the burdens.

We do not know the final effects of the MTN on trade and employment, but the tables which accompany my testimony show the change in jobs, both directly, as well as indirectly in supplying industries, that are related to a $1 million change in net trade in specific individual industries.

For example, a $1 million increase in computer exports would create 22 new jobs in the computer industry and 54 jobs in industries supplying inputs to the computer industry.

However, these increases in jobs must be balanced against the decrease in labor demand for industries which will experience increased import competition and, in turn, for their supplying sectors. An increase of $1 million of imports in the apparel industry would reduce labor demand by 35 jobs in apparel and 54 jobs in supplying industries, other things being equal.

Our final analysis of the net employment impact of U.S. and foreign tariff cuts is not complete because final offers have not been made, but past studies have shown that the net impact, as well as the impact upon each industry, is likely to be small.

For example, the research summarized in the Congressional Budget Office's paper on the MTN showed a net impact of +900 to −37,300 jobs. A loss of 37,000 jobs represents 0.04 percent of the labor force in manufacturing.

In individual industries, the impact never exceeded 5 percent of the industry's labor force, even with a tariff cut of 60 percent.

But the current U.S. offer averages only between 30 and 35 percent so that the sectoral impacts should be even smaller.

The recently released CBO report stated that the tariff cuts from the MTN would have an excessive adverse effect on the unskilled and the economically disadvantaged.

Those results were based upon a hypothetical across-the-board tariff cut of 50 to 60 percent. More importantly, I think the CBO results did not take into account the industrial sectors which were exempt from the negotiations or the lower tariff cuts negotiated in several sensitive areas.

For example, nonrubber footwear and TV sets were exempt from tariff cuts while in other industries such as ceramic tile and leather products, the tariff cuts were very small.

When the results of the actual negotiations are analyzed, the conclusion of the CBO report that the negotiations would impact

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heavily on the unskilled and economically disadvantaged needs to be modified.

I might add that the negotiating team, through extensive consultations, worked closely with labor and industry advisory groups, and other interested parties, including Members of Congress and their staffs, to identify sensitive sectors.

Our preliminary analysis suggests that by and large they were successful.

I won't go into the nontariff barrier codes.

Negotiating any agreement requires giving as well as getting. We have had to agree to modify some U.S. practices, such as the buy American laws and the injury test for subsidy cases. But in general, we have succeeded in maximizing the benefits that trade brings to the American people.

The process of implementing the codes in U.S. law gives us the opportunity to insure that we minimize the burdens. Through the existing adjustment assistance program and the administration of safeguards code, we have the tools to provide adequate and timely relief to U.S. workers injured by increasing imports.

We should make sure that measures against unfair trade provided by the nontariff codes are vigorously and quickly enforced.

We have worked closely with organized labor during the course of the negotiations. I am confident that the trade unions will give a careful evaluation to both the tariff-cutting agreements and the nontariff measures codes.

They are paying particular attention to the implementing legislation, which, in some ways, may be the most important part of the entire MTN.

As a final note, I would like to comment on the report of the House Committee on Ways and Means, Subcommittee on Trade, which deals with United States-Japan trade. It is a comprehensive and excellent review of the many trade problems involved in reducing our $12 billion deficit with Japan.

In one respect, I would modify its conclusions. The report describes various means which could be utilized to moderate the deficit—opening Japanese markets to our exports; Japanese investment in the United States; and moderating Japanese exports to the United States.

The report supports the first two but disavows the third. In respect to the third, I would suggest, instead, that Japan would be well advised to moderate its export drives in order to reduce the occasional export surges which have been characteristic of our trading patterns.

These export surges have had a substantial impact on certain industrial sectors, and have certainly contributed to the strained climate between the two countries.

A moderation of the export drives which have led to these surges would make a noticeable contribution to improving our balance of trade and reducing the tensions between us.

Thank you. I will now answer any questions you may have.

[Complete statement of Mr. Samuel follows:]

STATEMENT OF HOWARD D. SAMUEL, DEPUTY UNDER SECRETARY, U.S. DEPARTMENT OF LABOR

Mr. Chairman and Members of the Committee: I am pleased to be here to discuss the export implications of the Multilateral Trade Negotiations (MTN) agreements.

The increasing interdependence of nations in recent years has led to a substantial growth in international trade. In real terms world trade grew by 230 percent between 1960 and 1977, while Gross National Product (GNP) of the industrialized countries grew by 97 percent. Here in the United States the value of international trade has quadrupled in the last 10 years.

In almost all of the major countries, exports have become a more important factor in national output. In the U.S. the share of exports in GNP has gone from 4 percent in 1960 to over 7 percent today. It is predicted to go to over 10 percent by 1981. An important indication of the increasing role of exports in the health of the economy is their impact upon jobs in manufacturing. In an analysis of the impact of trade on employment, we have calculated that the number of manufacturing jobs related to exports, directly and indirectly, rose from 1 to 14 in 1964 to more than 1 in 8 by 1975.

Although the final foreign-tariff offers are not yet available, the industrial sectors in the United States which will benefit from trade liberalization and an expansion of trade are, in general, the same sectors in which the United States has traditionally had a strong comparative advantage. They include: aircraft, computers and electrical equipment and machinery. These sectors were identified in the Department of Labor trade and employment analysis of November 15, 1978, as among those in which trade had the most favorable impact on job opportunities between 1964 and 1975.

For example, the increase in exports of computers between 1964 and 1975 was responsible for an increase of about 38,500 jobs directly and indirectly. Directly, exports were responsible for 19 percent of the jobs in the computer industry in 1964. By 1975, 37 percent of computer industry jobs were export related. In aircraft, the proportion rose from 20 to 35 percent. Clearly exports are playing a more significant role in providing employment opportunities in key industries.

In general, international trade benefits our Nation. Trade makes it possible for us to have raw materials and manufactured products, which we might not otherwise have from other nations. And in return we are able to sell our commodities abroad thus creating more jobs in export industries.

But besides bringing benefits from the increase in exports, trade can also bring burdens. It is workers in import sensitive industries which have to bear the burden of adjustment for a policy of open trade. Unfortunately, the burdens usually fall on those least able to bear them: working people, often the least skilled, women, and members of minority groups. Therefore, we have to make sure that when we encourage the growth of international trade, everything is done to maximize its benefits and minimize its burdens. That was the basic purpose of the MTN.

The Multilateral Trade Negotiations will expand trade and increase employment in export-oriented industries. We do not know the final effects of the MTN on trade and employment, but the tables which accompany my testimony show the change in jobs, both directly, as well as indirectly in supplying industries, that are related to a 1 million dollar change in net trade in specific individual industries. For example, a 1 million dollar increase in computer exports would create 22 new jobs in the computer industry and 54 jobs in industries supplying inputs to the computer industry.

However, these increases in jobs must be balanced against the decrease in labor demand in industries which will experience increased import competition and in turn, in their supplying sectors. An increase of 1 million dollars of imports in the apparel industry would reduce labor demand by 35 jobs in apparel and 54 jobs in supplying industries, other things being equal.

Our analysis of the net employment impact of U.S. and foreign tariff cuts is not complete because final offers have not been made, but past studies have shown that the net impact, as well as the impact upon each industry, is likely to be small. For example, the research summarized in the Congressional Budget Office's (CBO) background paper on the MTN showed a net impact of +900 to −37,300 jobs. A loss of 37,000 jobs represents 0.4 percent of the labor force in manufacturing. In individual industries, the impact never exceeded 5 percent of the industry's labor force, even with a tariff cut of 60 percent. But the current U.S. offer averages only between 30 and 35 percent so that the sectoral impacts should be even smaller.

The MTN not only reduced foreign tariff barriers to U.S. exports but alos U.S. tariffs on imported products. In the course of negotiating reductions in our tariffs, the Administration was careful to give special consideration to U.S. industries sensitive to imports.

The recently released CBO report stated that the tariff cuts from the MTN would have an excessive adverse effect on the unskilled and the economically disadvantaged. Those results were based upon a hypothetical across-the-board tariff cut of 50 to 60 percent, while actual U.S. tariff cut will average under 35 percent. More importantly, the CBO results did not take into account the industrial sectors which were exempt from the negotiations or the lower tariff cuts negotiated in several sensitive sectors. For example, nonrubber footwear and TV sets were exempt from tariff cuts while in other industries such as ceramic tile and leather products, the tariff cuts were very small.

An examination of the demographic and occupational characteristics of workers in industries which were excepted from tariff cuts or given lower than normal cuts reveals that the workers were more often female, members of minorities, older and economically disadvantaged. Over 70 percent of the workers in those sectors given special consideration in the MTN were unskilled compared with less than 50 percent in manufacturing as a whole. These results are included in our critique of the CBO report which is being forwarded with my testimony.

Thus, when the results of the actual negotiations are analyzed, the conclusion of the CBO report that the negotiations would impact heavily on the unskilled and economically disadvantaged needs to be modified. Although it is true that import-sensitive industries have more than a proportionate number of economically disadvantaged workers, these industries were given smaller tariff cuts to avoid having the adjustment burden fall disproportionately on those least able to afford it. The negotiating team, through extensive consultations, worked closely with labor and industry advisory groups, and other interested parties, including members of Congress and their staffs, to identify sensitive sectors. Our preliminary analysis suggests that by and large they were successful.

The CBO report also did not take account of the nontariff barrier codes which have been negotiated. The codes on nontariff barriers should produce a substantial net gain in U.S. export opportunities.

The reason is simple. The U.S. uses far fewer measures that have the effect of distorting trade. The new codes will have a major effect on other nations, forcing them to play by the same rules we already play by.

Many other countries, for example, have virtually closed their doors to U.S. suppliers in government procurement markets. The U.S. procurement policy, even with the Buy America laws, is more visible and far less restrictive. The new code on government procurement should correct that imbalance.

The Standards code should make it substantially easier for U.S. exports to meet foreign standards, without weakening U.S. health, safety or quality standards.

The Safeguards code, still being negotiated, will oblige signatory nations to follow the same visible and predictable procedures that we do now under our escape clause.

Negotiating any agreement requires giving as well as getting. We have had to agree to modify some U.S. practices, such as the Buy American laws and the injury test for subsidy cases. But in general, we have succeeded in maximizing the benefits that trade brings to the American people.

The process of implementing the codes in U.S. law gives us the opportunity to insure that we minimize the burdens. Through the existing adjustment assistance program and the administration of the safeguards code, we have the tools to provide adequate and timely relief to U.S. workers injured by increasing imports.

We should make sure that measures against unfair trade provided by the nontariff codes are vigorously and quickly enforced.

We have worked closely with organized labor during the course of the negotiations. I am confident that the trade unions will give a careful evaluation to both the tariff-cutting agreements and the nontariff measures codes. They are paying particular attention to the implementing legislation, which may be the most important part of the entire MTN.

As world trade continues to have a larger impact on the economy, all of us have an obligation to ensure that international trade adds to, rather than detracts from, our job opportunities and real income.

As a final note, I would like to comment on the report of the House Committee on Ways and Means, Subcommittee on Trade, which deals with United States-Japan Trade. It is a comprehensive and excellent review of the many trade problems involved in reducing our $12 billion deficit with Japan. In one respect, I would modify its conclusions. The report describes various means which could be utilized to moderate the deficit—opening Japanese markets to our exports; Japanese investment in the U.S.; and moderating Japanese exports to the U.S. The report supports the first two but disavows the third. In respect to the third, I would suggest, instead, that Japan would be well advised to moderate its export drives in order to reduce the occasional export surges which have been characteristic of our trading patterns. These export surges have had a substantial impact on certain industrial sectors, and have certainly contributed to the strained climate between the two countries. A moderation of the export drives which have led to these surges would make a noticeable contribution to improving our balance of trade and reducing the tensions between us.

Thank you. I will now answer any questions you may have.

APPENDIX TABLE

Howard D. Samuel
Deputy Under Secretary
for International Labor Affairs

Bureau of International Labor Affairs
U. S. Department of Labor

Direct and Indirect Labor Requirements Associated with a One-Million Dollar Change in Net Trade.

DIRECT, INDIRECT, AND TOTAL LABOR REQUIREMENTS IN MAN-YEARS PER MILLION DOLLARS OF FINAL DEMAND (1976 PRICES) GENERATED USING THE 367 SECTOR DOMESTIC-BASED INPUT/OUTPUT TABLE WITH 1976 LABOR/OUTPUT RATIOS

I-O	INPUT-OUTPUT CATEGORY	DIRECT	INDIRECT	TOTAL
101	DAIRY FARM PROD	39.488	27.904	67.391
102	POULTRY,EGGS	27.507	51.547	79.054
103	LIVESTOCK PROD	13.904	36.432	50.336
201	COTTON	40.742	32.800	73.542
202	GRAINS,GRASS SEED	8.580	25.236	33.816
203	TOBACCO	90.958	17.889	108.847
204	FRUITS,TREE NUTS	67.756	41.557	109.313
205	VEGET,SUGAR,MISC CROPS	28.017	29.149	57.166
206	OIL BEARING CROPS	15.594	19.566	35.160
207	HORTICULT SPECIALTIES	65.583	19.171	84.754
300	FORESTRY,FISHERY PROD	21.559	31.296	52.855
400	AG,FOREST,FISHERY SERV	91.551	22.673	114.224
500	IRON,FERROALLOY MINING	10.883	26.333	37.217
601	COPPER ORE MINING	19.135	18.670	37.805
602	OTHER NONFERR. MINING	22.077	18.467	40.544
700	COAL MINING	14.255	9.306	23.561
800	CRUDE PETRO,NATUR GAS	8.673	7.700	16.372
900	STONE,CLAY MINING	28.356	25.792	54.148
1000	CHEM,FERTILIZER MINING	12.622	19.383	32.005
1101	NEW CONSTRUC,RESIDENT	41.365	45.164	86.529
1102	NEW CONSTRUC,NONRESID	45.911	39.087	84.998
1103	NEW CONSTRUC,UTILITIES	41.040	39.255	80.295
1104	NEW CONSTRUC,HIGHWAYS	43.553	31.872	75.425
1105	NEW CONSTRUC,OTHER	42.376	32.250	74.626
1201	REPAIR CONSTRUC,RESID	50.437	51.890	102.327
1202	REPAIR CONSTRUC,OTHER	50.437	37.685	88.122
1301	GUIDED MISSILES	18.390	25.309	43.699
1302	AMMO,EXC SMALL ARMS	8.518	28.536	37.053
1303	TANKS,TANK COMPONENTS	7.265	34.923	42.188
1304	SIGHTING,FIRE EQUIP	9.949	40.086	50.035
1305	SMALL ARMS	11.227	27.665	38.893
1306	SMALL ARMS AMMO	10.274	30.638	40.913
1307	OTHER ORDNANCE	11.695	28.969	40.664
1401	MEAT PRODUCTS	7.929	48.079	56.008
1402	CREAMERY BUTTER	4.200	73.222	77.422
1403	CHEESE	3.691	46.985	50.675
1404	CONDENSED,EVAP. MILK	3.009	37.084	40.093
1405	ICE CREAM,FROZ DESSERT	10.255	51.629	61.884
1406	FLUID MILK	9.539	61.167	70.706
1407	CANNED,CURED SEA FOOD	12.205	30.172	42.377
1408	CANNED SPECIALTIES	10.762	42.778	53.540
1409	CANNED FRUITS,VEGET	14.661	44.645	59.306
1410	DEHYDRATED FOOD PROD	12.474	49.076	61.550
1411	PICKLES,SALAD DRESS	11.801	45.624	57.425
1412	FRESH,FROZ FISH	13.212	26.626	39.838
1413	FROZ FRUITS,VEGET	17.052	44.976	62.028
1414	FLOUR AND CEREAL	5.043	37.926	42.970
1415	ANIMAL,FOWL FEEDS	5.219	41.342	46.561
1416	RICE MILLING	4.004	43.184	47.188
1417	WET CORN MILLING	7.891	24.865	32.756

DIRECT, INDIRECT, AND TOTAL LABOR REQUIREMENTS IN MAN-YEARS PER MILLION DOLLARS OF FINAL DEMAND (1976 PRICES) GENERATED USING THE 367 SECTOR DOMESTIC-BASED INPUT/OUTPUT TABLE WITH 1976 LABOR/OUTPUT RATIOS

I-O	INPUT-OUTPUT CATEGORY	DIRECT	INDIRECT	TOTAL
1418	BAKERY PRODUCTS	19.854	23.967	43.821
1419	SUGAR	7.392	36.159	43.551
1420	CANDY,RELATED PROD	15.566	28.803	44.369
1421	ALCOHOLIC BEVERAGES	3.898	26.779	30.677
1422	SOFT DRINKS	12.915	27.098	40.013
1423	FLAVOR EXTRACTS,SIRUPS	3.960	30.048	34.008
1424	COTTONSEED OIL MILLS	9.945	79.363	89.309
1425	SOYBEAN OIL MILLS	2.203	39.232	41.435
1426	VEGETABLE OIL MILLS	4.224	35.500	39.724
1427	ANIMAL FATS,OILS	12.106	28.876	40.982
1428	ROASTED COFFEE	3.732	14.421	18.153
1429	SHORTENING,COOKING OIL	5.973	45.049	51.022
1430	MFD. ICE	52.396	23.375	75.771
1431	MACARONI,SPAGHETTI	19.658	31.774	51.432
1432	FOOD PREPARATIONS,NEC	16.458	36.739	53.197
1501	CIGARETTES, CIGARS	5.182	32.863	38.045
1502	TOBACCO STEMMING,REDRY	7.852	91.348	99.200
1601	BROADWOVEN FABRIC MILL	23.358	46.591	69.948
1602	NARROW FABRIC MILLS	27.930	29.155	57.086
1603	YARN&TEXTILE FINISHING	26.227	51.604	77.831
1604	THREAD MILLS	20.383	40.935	61.318
1701	FLOOR COVERINGS	15.610	57.583	73.193
1702	FELT GOODS	39.617	57.165	96.782
1703	LACE GOODS	56.293	25.700	81.993
1704	PADS,UPHOLSTERY FILL	21.881	24.801	46.682
1705	PROCESS TEXTILE WASTE	52.218	37.955	90.174
1706	COATED FABRIC	20.592	35.206	55.799
1707	TIRE CORD,FABRIC	19.914	41.072	60.987
1708	SCOUR,COMBING PLANTS	74.588	73.735	148.323
1709	CORDAGE AND TWINE	36.123	29.162	65.284
1710	TEXTILE GOODS,NEC	28.127	36.658	64.785
1801	HOSIERY	43.107	54.098	97.205
1802	KNIT APPAREL MILLS	31.552	47.166	78.718
1803	KNIT FABRIC MILLS	17.912	71.869	89.781
1804	APPAREL,PURCHASED MATL	35.134	50.548	85.682
1901	CURTAINS AND DRAPES	34.632	58.306	92.938
1902	HOUSEFURNISHINGS,NEC	26.829	71.447	98.276
1903	FABRICATED TEXTILES,NEC	25.463	48.420	73.883
2001	LOGGING	21.524	24.741	46.265
2002	SAWMILLS,PLANING MILLS	26.344	28.541	54.884
2003	HARDWOOD FLOORING	49.979	40.564	90.542
2004	SPECIAL PROD SAWMILLS	26.405	23.161	49.566
2005	MILLWORK	19.317	33.516	52.833
2006	VENEER AND PLYWOOD	17.747	32.275	50.022
2007	PREFAB WOOD STRUCTURES	17.182	43.862	61.044
2008	WOOD PRESERVING	12.183	26.432	38.615
2009	WOOD PRODUCTS,NEC	27.799	32.601	60.401
2100	WOODEN CONTAINERS	23.941	35.357	59.298
2201	WOOD HOUSE FURNITURE	38.631	35.928	74.559
2202	UPHOLSTER HOUSE FURN	37.204	41.716	78.920

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DIRECT, INDIRECT, AND TOTAL LABOR REQUIREMENTS IN MAN-YEARS PER MILLION DOLLARS OF FINAL DEMAND (1976 PRICES) GENERATED USING THE 367 SECTOR DOMESTIC-BASED INPUT/OUTPUT TABLE WITH 1976 LABOR/OUTPUT RATIOS

I-O	INPUT-OUTPUT CATEGORY	DIRECT	INDIRECT	TOTAL
2203	METAL HOUSE FURNITURE	31.376	33.931	65.307
2204	MATTRESSES, BEDSPRINGS	29.412	48.434	77.846
2301	WOOD OFFICE FURNITURE	28.346	35.926	64.272
2302	METAL OFFICE FURNITURE	22.542	25.781	48.323
2303	PUBLIC BUILDING FURN	28.299	31.143	59.442
2304	WOOD PARTITION,FIXTURE	28.974	32.216	61.189
2305	METAL PARTITION,FIXTUR	24.281	30.025	54.307
2306	BLINDS AND SHADES	23.538	28.561	52.099
2307	FURNITURE,FIXTURES,NEC	28.505	32.551	61.056
2401	PULP MILLS	5.645	23.373	29.017
2402	PAPER MILLS	12.543	29.336	41.878
2403	PAPERBOARD MILLS	10.303	28.717	39.020
2404	ENVELOPES	25.588	31.311	56.900
2405	SANITARY PAPER PROD	6.250	25.102	31.352
2406	WALLPAPER MILLS	18.746	30.543	49.289
2407	CONVERTED PAPER,NO BOX	14.737	29.751	44.488
2500	PAPER CONTAINERS,BOXES	16.760	29.651	46.411
2601	NEWSPAPERS	35.700	24.919	60.619
2602	PERIODICALS	15.797	36.467	52.264
2603	BOOK PRINTING,PUBLISH	16.827	30.899	47.726
2604	MISC. PUBLISHING	26.193	20.694	46.886
2605	COMMERCIAL PRINTING	25.331	26.145	51.476
2606	BUSINESS FORMS,BINDERS	22.008	21.082	43.090
2607	GREETING CARDS	28.175	25.366	53.540
2608	MISC. PRINTING SERVICE	40.263	18.285	58.548
2701	INDUSTRIAL CHEMICALS	7.897	23.115	31.012
2702	FERTILIZERS	9.996	39.390	49.386
2703	AGRICULTURAL CHEMICALS	3.854	15.091	18.945
2704	MISC. CHEMICAL PROD	11.268	25.691	36.959
2801	PLASTIC MATLS,RESINS	4.577	28.554	33.132
2802	SYNTHETIC RUBBER	3.645	31.858	35.503
2803	CELLULOS MANMADE FIBER	15.110	31.090	46.200
2804	ORGANIC FIBER,NONCELL	18.099	41.638	59.736
2901	DRUGS	13.317	39.420	52.737
2902	CLEANING PREPARATIONS	7.517	34.740	42.257
2903	TOILET PREPARATIONS	11.522	68.746	80.268
3000	PAINTS, ALLIED PROD	18.053	29.682	47.735
3101	PETROLEUM REFINING	1.895	16.371	18.266
3102	PAVING MIXTURES,BLOCKS	10.161	21.136	31.298
3103	ASPHALT FELTS, COATING	10.891	20.112	31.003
3201	TIRES AND INNER TUBES	9.926	27.038	36.965
3202	RUBBER FOOTWEAR	32.566	31.107	63.673
3203	RECLAIMED RUBBER,MISC	20.827	28.217	49.044
3204	MISC. PLASTIC PROD	13.982	25.691	39.673
3300	INDUST LEATHER,TANNING	15.525	18.601	34.126
3401	FOOTWEAR CUT STOCK	24.278	25.800	50.078
3402	NONRUBBER FOOTWEAR	41.489	28.349	69.839
3403	OTHER LEATHER PROD	46.254	39.631	85.886
3501	GLASS,EXC CONTAINERS	19.884	21.397	41.282
3502	GLASS CONTAINERS	21.591	17.619	39.210

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DIRECT, INDIRECT, AND TOTAL LABOR REQUIREMENTS IN MAN-YEARS PER MILLION DOLLARS OF FINAL DEMAND (1976 PRICES) GENERATED USING THE 367 SECTOR DOMESTIC-BASED INPUT/OUTPUT TABLE WITH 1976 LABOR/OUTPUT RATIOS

I-O	INPUT-OUTPUT CATEGORY	DIRECT	INDIRECT	TOTAL
3601	CEMENT,HYDRAULIC	9.707	19.059	28.766
3602	BRICK,CLAY TILE	33.096	19.829	52.925
3603	CERAMIC WALL,FLOORTILE	36.211	29.235	65.446
3604	CLAY REFRACTORIES	20.634	24.760	45.394
3605	STRUCTURAL CLAY,NEC	31.127	24.101	55.229
3606	VITREOUS PLUMBING FIXT	31.888	18.904	50.792
3607	FOOD UTENSILS,POTTERY	55.512	15.818	71.330
3608	PORCELAIN ELECT SUPPLY	32.102	17.550	49.652
3609	POTTERY PRODUCTS,NEC	43.063	22.536	65.599
3610	CONCRETE BLOCK,BRICK	18.153	27.155	45.308
3611	CONCRETE PRODUCTS,NEC	21.720	23.439	45.159
3612	READY-MIXED CONCRETE	12.140	27.933	40.073
3613	LIME	14.357	17.963	32.320
3614	GYPSUM PRODUCTS	13.708	25.262	38.970
3615	CUT STONE, STONE PROD	38.458	23.868	62.326
3616	ABRASIVE PRODUCTS	18.857	29.769	48.626
3617	ASBESTOS PRODUCTS	19.908	26.361	46.269
3618	GASKETS, INSULATIONS	29.121	30.941	60.062
3619	MINERALS, GROUND	17.278	35.369	52.647
3620	MINERAL WOOL	13.576	20.127	33.703
3621	NONCLAY REFRACTORIES	15.644	28.769	44.413
3622	NONMETAL MINERAL PROD	25.549	26.625	52.174
3701	FURNACES, STEEL PROD	11.006	23.410	34.416
3702	IRON, STEEL FOUNDRIES	22.740	18.892	41.631
3703	IRON, STEEL FORGINGS	12.424	23.636	36.060
3704	PRIMARY METAL PROD,NEC	20.706	23.764	44.470
3801	PRIMARY COPPER	5.079	41.665	46.744
3802	PRIMARY LEAD	4.699	41.435	46.134
3803	PRIMARY ZINC	8.646	25.134	33.780
3804	PRIMARY ALUMINUM	4.368	25.501	29.870
3805	PRIMARY NONFERR METALS	8.567	21.234	29.801
3806	SECONDARY NONFER METAL	5.601	24.176	29.777
3807	COPPER ROLLING,DRAWING	9.750	33.464	43.214
3808	ALUM. ROLLING,DRAWING	8.611	26.588	35.199
3809	NONFER ROLLING,DRAWING	9.079	24.352	33.431
3810	NONFERR WIRE DRAWING	12.850	36.537	49.387
3811	ALUMINUM CASTING	16.737	20.549	37.286
3812	BRASS,COPPER CASTINGS	22.203	29.246	51.449
3813	NONFERR CASTINGS,NEC	15.163	16.664	31.827
3814	NONFERR FORGINGS	14.165	31.112	45.277
3901	METAL CANS	7.892	26.383	34.276
3902	METAL BARRELS,PAILS	12.820	29.983	42.803
4001	METAL SANITARY WARE	16.980	26.271	43.251
4002	PLUMBING FITTINGS	15.797	34.177	49.974
4003	HEATING EQUIP,EXC ELEC	19.127	38.357	57.484
4004	FABRICATED STRUC STEEL	20.801	26.221	47.022
4005	METAL DOORS,SASH,TRIM	30.375	30.038	60.413
4006	FABRICATED PLATE WORK	21.074	28.714	49.788
4007	SHEET METAL WORK	22.171	26.464	48.635
4008	ARCHITECTURAL METAL	27.381	35.955	63.336

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DIRECT, INDIRECT, AND TOTAL LABOR REQUIREMENTS IN MAN-YEARS PER MILLION DOLLARS OF FINAL DEMAND (1976 PRICES) GENERATED USING THE 367 SECTOR DOMESTIC-BASED INPUT/OUTPUT TABLE WITH 1976 LABOR/OUTPUT RATIOS

I-O	INPUT-OUTPUT CATEGORY	DIRECT	INDIRECT	TOTAL
4009	MISC. METALWORK	18.686	30.609	49.295
4101	SCREW,BOLT,NUT,WASHER	21.206	20.893	42.098
4102	METAL STAMPINGS	18.046	24.053	42.099
4201	CUTLERY	20.207	36.336	56.543
4202	HAND,EDGE TOOLS,SAWS	19.560	23.228	42.788
4203	HARDWARE,NEC	21.634	25.349	46.983
4204	COATING,ENGRAVE SERV	29.411	19.886	49.298
4205	MISC. WIRE PRODUCTS	19.671	28.566	48.237
4206	SAFES AND VAULTS	17.994	28.405	46.399
4207	STEEL SPRINGS	16.611	32.825	49.437
4208	PIPE,VALVES,PIPE FIT	15.343	22.973	38.317
4209	COLLAPSIBLE TUBES	30.776	23.901	54.678
4210	METAL FOIL,LEAF	14.944	47.258	62.202
4211	FABRICATED METAL PROD	18.096	29.770	47.866
4301	STEAM ENGINES,TURBINES	12.723	25.633	38.357
4302	INTERNAL COMBUST ENGIN	13.132	31.380	44.512
4400	FARM MACHINERY	14.265	31.768	46.033
4501	CONSTRUCTION MACHINERY	13.242	24.768	38.009
4502	MINING MACHINERY	14.328	26.829	41.156
4503	OIL FIELD MACHINERY	15.513	19.142	34.655
4601	ELEVATOR,MOVING STAIRS	22.201	28.718	50.919
4602	CONVEYORS, AND EQUIP	19.938	31.142	51.080
4603	HOISTS,CRANES,MONORAIL	17.912	28.569	46.481
4604	INDUST TRUCKS,TRACTORS	17.648	30.202	47.850
4701	MACHINE TOOL,METAL CUT	23.095	23.976	47.072
4702	MACHINE TOOL,METALFORM	21.245	25.461	46.706
4703	DIES AND TOOLS	29.946	24.436	54.382
4704	METALWORKING MACHINERY	26.429	29.926	56.355
4801	FOOD PRODUCT MACHINES	16.839	23.998	40.837
4802	TEXTILE MACHINERY	26.013	28.651	54.664
4803	WOODWORK MACHINERY	20.176	29.792	49.969
4804	PAPER INDUSTRY MACHINE	14.435	25.964	40.399
4805	PRINTING TRADE MACHINE	17.392	24.539	41.931
4806	SPECIAL INDUST MACHINE	14.694	24.287	38.981
4901	PUMPS AND COMPRESSORS	17.377	29.140	46.518
4902	BALL, ROLLER BEARINGS	22.834	24.514	47.348
4903	BLOWERS AND FANS	16.474	24.122	40.597
4904	INDUSTRIAL PATTERNS	23.667	19.476	43.143
4905	POWER TRANSMISSION EQ	20.297	24.569	44.866
4906	INDUST FURNACES,OVENS	14.285	27.261	41.546
4907	INDUSTRIAL MACHINERY,NEC	20.014	27.434	47.448
5000	MACHINE SHOP PROD	31.820	19.587	51.408
5101	COMPUTING MACHINES	22.413	53.899	76.312
5102	TYPEWRITERS	25.787	25.433	51.220
5103	SCALES AND BALANCES	22.539	25.501	48.040
5104	OFFICE MACHINES,NEC	19.442	28.507	47.949
5201	VENDING MACHINES	21.076	41.370	62.446
5202	COMMERCIAL LAUNDRY EQ	22.726	40.098	62.824
5203	REFRIGERATION MACHINE	14.470	42.828	57.298
5204	MEASURE,DISPENSE PUMPS	15.090	28.708	43.798

DIRECT, INDIRECT, AND TOTAL LABOR REQUIREMENTS IN MAN-YEARS PER MILLION DOLLARS OF FINAL DEMAND (1976 PRICES) GENERATED USING THE 367 SECTOR DOMESTIC-BASED INPUT/OUTPUT TABLE WITH 1976 LABOR/OUTPUT RATIOS

I-O	INPUT-OUTPUT CATEGORY	DIRECT	INDIRECT	TOTAL
5205	SERVICE INDUST MACHINES	18.264	37.747	56.011
5301	ELECTRIC MEASURE INSTR	32.972	33.442	66.414
5302	TRANSFORMERS	25.519	31.963	57.483
5303	SWITCHBOARD APPARATUS	22.598	28.697	51.296
5304	MOTORS,GENERATORS	25.944	27.738	53.683
5305	INDUSTRIAL CONTROLS	28.656	31.709	60.365
5306	WELDING APPARATUS	15.201	26.831	42.031
5307	CARBON, GRAPHITE PROD	19.944	21.645	41.589
5308	ELECT INDUST APPARATUS	35.383	37.851	73.233
5401	HOUSEHOLD COOKING EQ	18.539	42.794	61.333
5402	HOUSE REFRIG,FREEZERS	15.212	39.559	54.771
5403	HOUSE LAUNDRY EQUIP	11.817	43.257	55.073
5404	ELECT HOUSEWARES,FANS	24.480	52.153	76.632
5405	HOUSE VACUUM CLEANERS	18.942	38.235	57.177
5406	SEWING MACHINES	22.204	28.138	50.342
5407	HOUSE APPLIANCES,NEC	14.463	43.595	58.059
5501	ELECTRIC LAMPS	25.113	21.316	46.429
5502	LIGHTING FIXTURES	30.696	32.336	63.032
5503	WIRING DEVICES	28.464	25.965	54.428
5601	RADIO, TV SETS	15.523	66.734	82.257
5602	PHONOGRAPH RECORDS	17.133	36.854	53.987
5603	TELE-PHONE,GRAPH	25.980	24.022	50.002
5604	RADIO,TV COMMUNICAT EQ	28.958	28.726	57.684
5701	ELECTRON TUBES	27.148	37.559	64.707
5702	SEMICONDUCTORS	53.952	48.698	102.649
5703	ELECTRONIC COMPONENTS	30.371	46.517	76.888
5801	STORAGE BATTERIES	18.571	34.150	52.721
5802	PRIMAR BATTERY,WET,DRY	18.299	29.012	47.311
5803	X-RAY APPARATUS,TUBES	14.923	23.817	38.739
5804	ENGINE ELECTRICAL EQ	18.470	25.565	44.035
5805	ELECTRICAL EQUIP,NEC	25.035	41.869	66.904
5901	TRUCK AND BUS BODIES	18.002	40.799	58.800
5902	TRUCK TRAILERS	13.309	42.234	55.542
5903	MOTOR VEHICLES,PARTS	8.641	34.101	42.742
6001	AIRCRAFT	13.961	31.755	45.716
6002	AIRCRAFT ENGINES,PARTS	17.871	29.357	47.228
6003	AIRCRAFT PROPELL,PART	23.099	46.527	69.626
6004	AIRCRAFT EQUIPMENT,NEC	23.087	30.591	53.678
6101	SHIPBUILDING,REPAIRING	22.237	23.961	46.198
6102	BOATBUILDING,REPAIRING	23.457	30.931	54.388
6103	LOCOMOTIVES, PARTS	13.895	29.157	43.053
6104	RAILROAD, STREET CARS	13.668	28.004	41.672
6105	MOTORCYCLE,BICYC,PARTS	26.723	33.197	59.920
6106	TRAILER COACHES	17.582	46.444	64.026
6107	TRANSPORTATION EQ,NEC	16.395	36.024	52.420
6201	ENGINEER,SCIENCE INSTR	25.712	40.358	66.070
6202	MECH MEASURE DEVICE	26.579	33.451	60.030
6203	AUTO TEMP CONTROLS	26.949	27.958	54.906
6204	SURGICAL,MED INSTRU	23.917	33.338	57.255
6205	SURGICAL APPLIANCE,SUP	27.300	38.463	65.763

DIRECT, INDIRECT, AND TOTAL LABOR REQUIREMENTS IN MAN-YEARS PER MILLION DOLLARS OF FINAL DEMAND (1976 PRICES) GENERATED USING THE 367 SECTOR DOMESTIC-BASED INPUT/OUTPUT TABLE WITH 1976 LABOR/OUTPUT RATIOS

I-O	INPUT-OUTPUT CATEGORY	DIRECT	INDIRECT	TOTAL
6206	DENTAL EQ, SUPPLIES	28.590	32.908	61.498
6207	WATCHES,CLOCKS,PARTS	26.033	45.131	71.164
6301	OPTICAL INSTRU,LENSES	31.115	44.266	75.380
6302	OPHTHALMIC GOODS	24.907	27.680	52.587
6303	PHOTOGRAPHIC EQ,SUPPLY	14.214	26.128	40.342
6401	JEWELRY	28.842	25.815	54.657
6402	MUSIC INSTRUMENT,PARTS	25.121	41.650	66.771
6403	GAMES, TOYS	18.014	36.592	54.605
6404	SPORT, ATHLETIC GOODS	24.297	35.693	59.990
6405	PENS, PENCILS	22.093	40.146	62.238
6406	ARTIFICIAL FLOWERS	21.920	30.122	52.041
6407	BUTTONS,PINS,FASTENERS	18.806	28.785	47.591
6408	BROOMS AND BRUSHES	18.432	35.169	53.601
6409	HARD FLOOR COVERING	10.318	29.489	39.807
6410	MORTICIANS GOODS	21.897	43.377	65.274
6411	SIGNS,ADVERTIS DISPLAY	18.659	26.363	45.023
6412	MISC. MANUFACTURES,NEC	39.102	36.374	75.476

U.S. Department of Labor

Bureau of International Labor Affairs
Washington, D.C. 20210

Reply to the Attention of IR (FERS)

MAR 30 1979

CRITICAL ASSESSMENT OF THE CBO BACKGROUND PAPER:
U.S. TRADE POLICY AND THE TOKYO ROUND OF
MULTILATERAL TRADE NEGOTIATIONS

The Congressional Budget Office's recent background paper on the Multilateral Trade Negotiations was a useful summary of past research on the impact of trade liberalization. The report provided a balanced discussion of the benefits from trade liberalization, but the discussion of the negative impact of trade liberalization did not take account of the treatment of sensitive sectors during the actual negotiations.

Based on hypothetical tariff-cutting formulas, the CBO background paper presents several illustrative estimates (by Baldwin & Lewis and Cline)* of the employment impact of various hypothetical multilateral tariff reductions. The CBO study was not able to use the actual tariff cut made in the Multilateral Trade Negotiations (MTN), which took account of many of the more sensitive sectors. For this and for other reasons, the employment and regional effects of the MTN shown in the CBO study are subject of modification. The study, however, does emphasize that the employment impact of such tariff cuts is likely to be very small. In fact, the employment impact of the current MTN is likely to be smaller and less concentrated in sensitive sectors than the estimates in the CBO report would indicate.

*Robert E. Baldwin and Wayne S. Lewis, "U.S. Tariff Effects on Trade and Employment in Detailed SIC Industries," U.S. Department of Labor (1978). William R. Cline, Naboro Kawanabe, T.O.M. Kronsjo, and Thomas Williams, Trade Negotiations in the Tokyo Round: A Quantitative Assessment (Washington, DC: The Brookings Institution, 1978), Partially funded by the U.S. Department of Labor.

In summary form the CBO conclusions need to be modified because:

1. The CBO employment estimates are based on 50 or 60% linear tariff reductions, while the current U.S. offer averages less than 35%, and it is non-linear. Sensitive (e.g., labor-intensive, low skilled) industries were subject to no tariff cut, or much smaller tariff cuts than non-sensitive items. Press accounts of the CBO report emphasized the "finding" that industries most likely to suffer from MTN tariff cuts would include footwear and TV sets, when in fact (as noted in a footnote for the CBO report) both rubber and nonrubber footwear as well as color TVs were excluded from MTN tariff cuts. Other industries such as apparel and leather products had smaller tariff cuts on the grounds of sensitivity. The actual cuts will have both a smaller gross employment impact and a smaller affect on low-skilled labor than formula reductions. An analysis of the characteristics of workers in sensitive industries is given below.
2. The CBO illustrations also neglect the increase in U.S. exports to LDCs which will accompany the growth in world trade brought about by the MTN. The LDCs are likely to spend a large fraction of their increased import expenditures on U.S. goods. Increased LDC purchases will also increase the positive employment impact of the MTN.

3. The consequences of the tariff cuts summarized by the

CBO were impact estimates of the change in the demand for labor. The estimates did not take account of other changes in the economy which would affect labor demand, such as demand growth or of changes in exchange rates. The tariff cuts are to be phased in over an eight-year period. The discussion of layoffs is not accurate without taking these factors into account or without considering normal employment growth and attrition.

4. Finally, the CBO examples do not take into account the trade and employment impact of the various non-tariff barrier codes negotiated in Geneva. Although very difficult to quantify, most experts believe that the U.S. is likely to gain in any multilateral reduction of N.T.B.s, particularly in the procurement and the standards code.

Two important points should be emphasized regarding the distributional consequences of the MTN. First, while employment opportunity losses in an industry are indicative of the level of the employment impact, they are not necessarily indicative of the costs of adjustment to trade. Rather than presuming that declines in industry employment opportunities result in an equivalent number of layoffs, the net employment impact should be expressed as a percentage of the industry's labor force and compared to the industry's employment growth trend and normal rate of attrition. Estimated employment opportunity declines resulting from the MTN will translate into a slower growth in employment -- rather than layoffs -- in some industries. Even in those industries where actual employment declines are expected to occur, all or part of the decline may be accomplished through a combination of a reduction in hiring and normal attrition, particularly when employment declines are to be spread out over eight years. Industries are then correctly identified as impacted when actual employment declines are expected to occur after controlling for employment growth and attrition.

Secondly, with regard to the distribution of geographical, occupational and demographic impacts, it is important to consider the differences in these industry and employee characteristics within the categories of impacted industries in light of the exception, offers, and counter-offers made by all parties during the negotiations. The characteristics of industries and employees who generally bear the costs of adjustment to trade may differ significantly from those affected by the MTN. MTN-impact analyses must compare industries impacted by trade trends with those given special consideration in the Tokyo Round to develop a picture of those segments of the labor force which are likely to bear trade-related adjustment costs.

In addition, consideration should be given to two other aspects of the distributional impacts: (1) the female and minority composition of employment varies within the group of MTN impacted industries, e.g., steel products and textiles; and (2) geographical employment impacts are difficult to predict given only a cross-sectional picture of industry employment by state. Even if employment declines are expected in an industry, it is difficult to predict which firms and which plants will actually experience declines.

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The Office of Foreign Economic Research is making detailed sectoral estimates of the trade and employment impact of the MTN tariff cuts based upon the actual U.S. and foreign offers. These estimates differ significantly from the impact discussed in the newspaper accounts of the CBO report because sensitive sectors were exempted from tariff cuts.

A preliminary analysis identified those sectors which were exempt from tariff cuts or had tariff cuts which were less than fifty percent of the Swiss formula cut. The remainder of this paper compares the demographic and occupational characteristics of the workers in those industries with the average for overall manufacturing.

The burden of adjustment to employment declines resulting from changes in trade falls upon the workers in import-sensitive industries. To the extent that worker demographic and occupational characteristics differ systematically between the trade-enhanced and import-sensitive industries, the costs of adjustment, will be borne disproportionately by particular segments of the labor force. Throughout the MTN negotiations special consideration was given to those industries where employment opportunities have been most heavily impacted by expanding trade, and, as a result, those segments of the labor force which are normally forced to bear the costs of adjustments to the expansion of trade.

The extent of the impact of these negotiations on the distribution of the adjustment burden can be higlighted by focusing on the demographic and occupational characteristics of workers in industries given special consideration. Table [illegible] presents summary statistics regarding worker characteristics in [illegible] industries granted special consideration, referred to [illegible] industries* and the overall average for

* Employment in these industries accounted for 11 percent of manufacturing

the manufacturing sector. The comparison indicates that these sensitive industries employ higher proportions of females, minority and older workers than the average for the manufacturing sector as a whole. Also, skill levels, educational attainment and earnings of workers in these industries are lower than the average for workers in the manufacturing sector.*

Demographic Composition of Employment in Sensitive Industries

Import-sensitive industries employ a substantially larger proportion of females than does the manufacturing sector. 62% of all employees in these sensitive industries are female as compared to 29% in the manufacturing sector. Minority workers also constitute a higher proportion of employees in these sensitive industries than in the manufacturing sector as a whole. Similarly, older workers (over 50 years of age) whose adjustment to job losses can be particularly costly, constitute a larger proportion of employees in sensitive industries, 30%, than in the manufacturing sector as whole, 20%. This fact combined with the similarity in the proportion of young workers in each group of industries, indicates that the adjustment burden to any MTN-related employment declines will not fall disproportionately on workers of any particular age group.

Earnings of Employees in Sensitive Industries

The percentage of the labor force in the sensitive industries which had total family incomes below the poverty level in 1969 was more than twice the percentage in manufacturing as a whole. These

*C.M. Aho and J. Orr "International Trade's Impact on U.S. Workers: Demographic and Occupational Characteristics of Workers in Trade-Sensitive Industries", Office of Foreign Economic Research, U.S. Department of Labor, March 1, 1979, showed that characteristics also differed systematically from the workers in trade-enhanced industries. The characteristics of workers in these "sensitive" industries are similar to those of workers in industries most strongly affected by trends in trade over the recent past.

high poverty rates reflect, among other things, the inability of these workers and their families to finance adjustments to job losses. Their disproportionate employment in sensitive industries indicates the successful attempts to reduce the earnings losses through negotiations. An examination of the distribution of employee earnings in 1969 shows that 9[illegible].5% of workers in these sensitive industries earned less than $10,000 compared to 77.9% in the overall manufacturing sector. Thus, not only are a greater percentage of workers in these sensitive industries living below the poverty level, but a larger percentage are earning less than the manufacturing average.

<u>Educational Attainment and Skill Levels of Employees in Sensitive Sectors</u>

The level of formal education embodied in the labor force in these two sets of industries is represented by two measures; one, the percentage of employees having completed high school, and two, the percentage of employees having completed 4 years of college. On both measures, employees in the sensitive industries had lower levels of educational attainment than workers in the overall manufacturing sectors -- 30.8% of workers in the sensitive industries completed high school and 2.2% completed college, while 36.6% of the manufacturing work force completed high school and 5.1% completed college.

This difference in educational attainment is mirrored in the difference in skill levels or human capital embodied in the labor forces of the respective sets of industries. On a wage basis, the skill index for the sensitive industries was 74% of the manufacturing average; 72.5% of the labor force of the sensitive industries was classified as unskilled as compared to 48.4% of the overall manufacturing labor force. The percentage of the work force classified as blue collar reveals similar results. Thus, on all three measures of skill, the industries given special consideration are those sectors which hire the largest percentage of unskilled workers.

The statistical summary indicates a clear systematic pattern in the characteristics of workers in the sensitive industries relative to the characteristics of workers in the manufacturing sector. These differences in characteristics, and earnings patterns in particular, suggest that those workers who, under expanding trade, would have to bear the burden of both the short run adjustment costs of changes in trade and potential declines in their long-run earnings capacity, are precisely those who were given special consideration in the MTN negotiations.

Thus, considering the demographic and occupational characteristics of the workers in industries which were treated with sensitivity during the negotiations, the CBO conclusion that the MTN would impact heavily on unskilled and economically disadvantaged workers needs to be modified. Through an extensive series of consultations with private sector advisory committees from labor and industry, care was taken to minimize the negative impact on sensitive sectors or on particular demographic and occupational subgroups in the labor force.

Demographic and Occupational Characteristics
of Workers in Industries Treated with Sensitivity
During the Multilateral Trade Negotiations
(percentage of the laborforce)

	Sensitive Industries	Manufacturing Average
Female 1/	62.3	28.6
Minority (non-white) 1/	11.2	9.9
Under 25 Years of Age 1/	16.6	16.4
Over 50 Years of Age 1/	30.1	19.8
Family Income Below the Poverty Level 1/	8.5	4.2
Annual Earnings Under $10,000 1/	90.5	77.9
High School (4 years) 1/	30.8	36.6
College (4 years) 1/	2.2	5.1
Skill measured as a percentage of the Average wage in manufacturing (1973) 2/	73.5	100.0
Unskilled Workers 3/	72.5	48.4
Blue-Collar Workers 4/	82.9	69.2

1. Source: Census of Population, 1970, Subject Reports: Industrial Characteristics, U.S. Dept. of Commerce, 1972, (Washington, DC: U.S. GPO)

2. Source: Employment and Earnings, U.S. Dept. of Labor. Index is the average wage in the industry divided by the average wage in manufacturing.

3. Source: Census of Population, 1970, Subject Reports: Occupations by Industry, U.S. Dept. of Commerce, 1973, (Washington, DC: U.S. GPO) Unskilled workers are defined to include operatives other than transport, transport operatives, other laborers and service workers. Skilled workers are defined to include professionals, managers, sales, clerical and craftsmen.

4. Same as 3. Blue-collar workers include all defined as unskilled plus craftsmen.

Senator STEVENSON. Thank you, sir.

What does the administration propose with respect to trade adjustment assistance? Will the administration have any proposals which would facilitate cross-sectoral adjustments required by these codes?

You cited the disparate effects on computers and textiles as an example. Our trade adjustment programs have never been very effective, it seems to me.

Will the administration have proposals for making them more so?

Mr. SAMUEL. I think in this specific area, Mr. Chairman, our feeling is that the special training opportunities offered by the adjustment assistance program now are probably the direction in which we are going and should be going.

I think, also, we have to be cautious in how far we do try to move labor forces from one sector to the other. The apparel industry has not so far lost and, because of a very careful consideration of the apparel industry, perhaps will not lose very greatly in terms of employment. I think if we as a government agency venture in and begin to remove workers from the apparel industry and turn them into computer operators, it may not be practical, and we may not be doing a very big favor for the apparel industry.

So I think we have to be very cautious in trying to make or even consider any wholesale changes from one industry to another.

As I indicated, the actual employment changes in the various sectors caused by the MTN is apt to be very, very small.

Senator STEVENSON. Do I take it then that the administration will be making no recommendations concerning existing trade adjustment programs?

Mr. SAMUEL. Well, the administration has not prepared a bill, nor has it submitted a complete proposal.

What it had done about a year and a half ago was to make certain comments on the bill which was introduced, in the House by Congressman Vanik, and in the Senate also.

We have maintained that position since then. We do suggest a number of changes in the present system of adjustment assistance.

Senator STEVENSON. What will be the effect of the trade agreement, if approved, on labor in the textile industry?

Mr. SAMUEL. I would be very reluctant to make a prediction in terms of anything specific, Mr. Chairman. I assume that the MTN itself will probably have a minimal effect.

As I say, the tariff-cutting exercise touched upon that industry very lightly because we recognized the sensitivity of the industry and the importance of the industry in our economy.

At the same time, as you know, the administration has announced a program with the industry and the unions to improve and speed up the administration of the Multi-Fiber Arrangement, or MFA. I hope between that program and the fact that the MTN, in treating the industry with a great deal of care, will actually have very little effect.

Senator STEVENSON. In what industries do you expect labor to be adversely affected, if any?

Mr. SAMUEL. I think the negotiators have tried to avoid in the negotiating exercise taking any action which would imperil industries which were already sensitive. It is very difficult to predict exactly industry-by-industry or worker-by-worker, which industry might be affected.

For one thing, our economy is very dynamic as you know. Industries which seem to be export-oriented now may become import-sensitive a few years from now.

So I really would hesitate to try to nail down or predict any sense of doom on the part of one industry or another.

Senator STEVENSON. Thank you.

Senator Tsongas?

Senator TSONGAS. Thank you, Mr. Chairman.

Do you have figures on shifts in labor patterns in terms of what kinds of industries people are involved with?

For example, in Massachusetts there is a shift from basic textile and shoe industries to computer, high-technology companies.

Is that a peril to other parts of the country?

Mr. SAMUEL. I am sorry?

Senator TSONGAS. In other parts of the country, do you find that shift happening elsewhere?

Mr. SAMUEL. I assume so. I don't have figures here, Senator, to indicate that. We have figures, of course, indicating where employment is, in which sectors employment is. We can compare it to figures of, let's say, 10 years ago to see what the changes are.

In the apparel industry to my recollection, and I come from that industry, 10 years ago employment, including textiles, was approximately 2,400,000. It's now probably between 100,000 and 200,000 fewer employees.

Senator TSONGAS. You have certainly had a significant increase in the work force over that period of time.

Where are they going? In terms of manufacturing. Leaving aside service industries.

Mr. SAMUEL. I think it would be hard to leave aside service industries because that is obviously where much of the work force is going.

I would like to prepare some figures for you and present them to you after the hearing in terms of where the changes in the labor force and markets have occurred.

Senator TSONGAS. How do you account for the increase in our GNP that is allocated to export?

Mr. SAMUEL. How do I account for the increase?

Senator TSONGAS. It certainly cannot be accounted for by aggressive government policies, the Export-Import Bank, for example. There is no official government policy, aggressive or otherwise. Why does it happen?

Mr. SAMUEL. I think that government policy is not the only factor affecting trade. It doesn't necessarily respond only to what the Government does. I assume as the economies of other nations become more sophisticated, particular the advanced, underdeveloped countries, for example, and even developed countries, that we are sharing more and more similar technologies, similar tastes and I assume have similar demands.

I suspect that process is going to continue in the future, as I indicated in my testimony, so that the world economic community is in effect getting much smaller.

Senator TSONGAS. So that projected increase of 10 percent by 1981 would continue irrespective of what the Government happened to do?

Mr. SAMUEL. I suspect what the Government does may contribute to it.

I don't think anything the Government can do can actually halt the process of economic integration on a global basis.

Senator TSONGAS. I don't think we are trying to halt it, I think we are trying to enhance it.

Mr. SAMUEL. I think government policy could enhance it to a certain extent, yes.

Senator TSONGAS. What about MTN, what effect will that have on percentage of GNP allocated to export?

Mr. SAMUEL. It's hard to predict. I would assume that since our goal in the MTN was to increase export opportunities and reduce export barriers, that the effect of the MTN would be to increase exports even further.

Again, it is very difficult to try to analyze quantitatively, partly because the results of the negotiations can't be quantitatively judged and partly because it depends so much on the degree to which we implement it and the forcefulness with which we implement the codes.

Certainly that is their purpose and design, and I think probably the results should go accordingly.

Senator TSONGAS. A final point.

Would it be fair to say as someone suggested that what the agreements do basically is encourage those industries that have for the most part higher wages and higher skills at the expense of those low-wage industries that we have traditionally relied upon?

Mr. SAMUEL. I would like to accept to the first part and not the last part. I think the MTN is designed to encourage export industries.

It's true it is more characteristic of export industries than import industries that they require high skills. But I hope we have through the care with which the tariff cuts have negotiated, avoided any serious damage at all to the industries which could be impacted by imports.

Senator TSONGAS. It's interesting the Government only does well and does not spread any ill will around. I am pleased to hear that.

Thank you, Mr. Chairman.

Senator STEVENSON. Thank you, Senator Tsongas.

Before both of you arrived, Ambassador McDonald testified as follows:

> "We anticipate the code will increase U.S exports in the next 3 to 5 years by between 1.34 and 2.34 billion annually. And U.S. imports, by only .34 billion or a net export gain of between $1 billion and $2 billion. We also expect an estimated net gain in job opportunities based on this code of between 50,000 and 100,000."

He went on to say that, "These estimates are deliberately on the conservative side".

Would you agree with his estimates?

Mr. SAMUEL. Mr. Chairman, I understand those figures may refer largely to the procurement code which is the only one which really can be measured.

Senator STEVENSON. You are right.

That observation is confined to the procurement code. Take all of the codes, presumably the estimates would be even more——

Mr. SAMUEL. It's very difficult, I think, to try to estimate what the results, for example, of the subsidies code would be because it's impossible to predict exactly what subsidies will come under attack and how effective we will be in overcoming them.

In the procurement code, it's perhaps a little more susceptible to quantitative analysis. However, there are still doubts about exactly what it will do, so there is in effect an escape clause in the procurement code. In three years there will be a review of the code so that we can take a look at it and make sure we are benefiting as we believe we will.

Senator STEVENSON. Well, I agree with what you have said. In this world in which price is only one factor, cartels and governments and multinationals turns the laws of supply and demand on their head, it's difficult to make confident predictions.

The results in the United States will depend on our own efforts. I don't think we can predict them with much confidence at the moment.

We may have, I may have some further questions for the record, Mr. Samuel. But unless Senator Tsongas has any more now, that's it.

Thank you, sir.

The committee is adjourned. The committee is recessed until 10:00 tomorrow morning in the same room. The committee is recessed.

[Whereupon, at 12:10 p.m., the committee was adjourned, to reconvene at 10 a.m., Thursday, April 5, 1979.]

MULTILATERAL TRADE NEGOTIATIONS

THURSDAY, APRIL 5, 1979

U.S. SENATE,
COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS,
SUBCOMMITTEE ON INTERNATIONAL FINANCE,
Washington, D.C.

The subcommittee met at 10 a.m., in room 5302 of the Dirksen Senate Office Building; Senator Stevenson (chairman of the subcommittee) presiding.

Senator STEVENSON. The subcommittee will come to order.

This morning we continue our hearings on the implications of the trade agreement for the United States and, in particular, our exports.

We are pleased to have as our witnesses today Dr. Robert Baldwin, from the University of Wisconsin at Madison, and Dr. William R. Cline, a senior fellow at the Brookings Institution. They will compose a panel.

I will invite them both to summarize their statements, if they would like, in which case I will place the full statements in the record.

May we proceed with you, Dr. Baldwin?

STATEMENTS OF ROBERT BALDWIN, PROFESSOR OF ECONOMICS, UNIVERSITY OF WISCONSIN AND WILLIAM R. CLINE, SENIOR FELLOW, THE BROOKINGS INSTITUTION

Dr. BALDWIN. Thank you, Senator. I think perhas I should begin by clarifying for the record just what my affiliation is. I see on the list of witnesses that I am listed as a consultant for the World Bank but, as you mentioned, and I put on my statement, I am also at the University of Wisconsin. I am a professor of economics at the University of Wisconsin, and do this year have a research grant from the World Bank. This research grant is processed through the university like an ordinary grant from the National Science Foundation or Ford Foundation, and it is the University of Wisconsin that pays my normal salary during this year.

Frankly, the World Bank does not consult me on anything at all. I have no idea what their policies are on these issues. It so happens that most of the data I want for my study is here in Washington, and I asked if they would provide me with office space, so I could undertake the study here. They were kind enough to do so.

The only reason I think I have a little card stating that I am a "consultant" is so that I can get in the building and by the guards. I speak solely as a professor of economics at Wisconsin.

Senator STEVENSON. Thank you for that clarification.

Dr. BALDWIN. One of the points I make in my testimony relates to a part of a study by the Congressional Budget Office that some of my staff friends in the Congress and the executive branch tell me has led to a negative reaction by Members of Congress toward the multilateral trade negotiations.

That part of the CBO study happens to summarize a study that I did for the Labor Department in 1975. Of course, it's somewhat flattering to see such eminent people paying attention to one's research, particularly since I couldn't get anybody's attention, when I first started talking about it, or even when it was finally published in 1978.

But I do think some of the press coverage missed the essential points of the study. One main point that emerged from the study was that the overall employment impact effects of a very significant tariff cut—I used 50 percent—are quite small. I estimated only a loss of 15,000 jobs from a duty cut of that magnitude. However, I did point out that certain sectors, particularly certain industries, could be considerably impacted by such a tariff cut.

Now much of the initial reaction I got dealt with the aggregate results. Some people, who were very worried about imports, were concerned about the minimal size of the employment effects that I got. They thought that they should have been much larger.

But I think that as more and more studies tended to confirm that these effects were going to be quite small overall, this concern subsided and readers began to focus more on another major point of the study; namely, that certain industries might be hurt by a deep tariff cut.

The implication of this is that we should take some action to prevent any serious injury.

We can either exclude some of these industries from the tariff cuts or we could cut import duties in these sectors less than the formula. In addition, we could spread the cuts out over a longer period of time. Finally, of course, we could provide better adjustment assistance for these industries. Well, it was too late really to do much on the adjustment assistance side, since the act had already been passed. What has in fact happened, is that some of the industries that I mentioned would be hurt have been excluded from the tariff cuts or the cuts made have been much smaller than the formula.

Of course, it wasn't in response to anything that I said. It was in response to political pressures from these groups. All I did was confirm that, indeed, when these people complained, they had a right to complain. They could be hurt.

So perhaps it gave the administration some comfort in knowing that in fact estimates of employment effects did seem to justify what these people were saying.

I understand that products such as footwear, television sets, and some miscellaneous consumer goods are either excluded from duty reductions or being cut less than the formula.

So I suspect now that if those estimates were run not for the 50-percent reduction that I did, but on what the actual offers are, these impacts would be very much less, particularly, the regional impact which caused the most concern.

I did find in my study that the relatively largest negative employment impact by region was in New England.

But the numbers were small, with only 3,000 jobs involved in the entire region. This region is where the footwear industry is concentrated as well as some of the other industries excluded from duty cuts. I suspect if we ran the estimates now, we would find a positive impact. They could in fact be run, if somebody wanted to do it. The fact that the cut now is not 50 percent, but more on the order of 30 percent makes the impact effects even less significant.

So, as I conclude in my testimony, I would be relatively reassured, if I were a legislator, about the impact in my area, given the small magnitude of my numbers, coupled with the response of the administration to various groups who feared they would be hurt.

The other point in my testimony had to do with trying to present the case of why I think it is in the interest of the United States to sign the nontariff barrier codes that are part of the Tokyo Round agreements.

I will be glad to talk in more detail on the particular codes, if you want.

The single point I would like to make is that these codes aren't going to solve our export and import problems by any means. If you read them, you find that their provisions are very vague, and some of them seem contradictory. This is the almost inevitable result of any negotiations. There is vagueness and fuzziness. Whether these things work depends upon not whether we sign the codes, but upon how well they are implemented and enforced in the future.

It is very important that the United States maintain a first-rate team in this whole trade area. We have a first-rate team now. Many of them are planning to leave; however, we must make sure we get the best people dealing with trade matters in the U. S. Government both here and over in Geneva.

It is absolutely essential that we be well prepared when we go over there and begin these panel deliberations.

The work that the Ways and Means Committee study reports that the Commerce Department is doing with the United States-Japanese trade typifies what I mean by good preparation.

I was in the Office of Special Trade Represenative during President Kennedy's period as the first Chief Economist, and I found that if you are well prepared then you have the tools to get things done at the bargaining table.

It's very important in the future implementation of these agreements that we are well prepared.

Thank you.

[Complete statement follows:]

PREPARED STATEMENT OF ROBERT E. BALDWIN, UNIVERSITY OF WISCONSIN-MADISON

U.S. TRADE POLICY AND THE TOKYO ROUND AGREEMENTS

I should like to focus on two issues. The first is a somewhat technical point concerning the interpretation of certain parts of a study of mine that were reported in a recent paper published by the Congressional Budget Office. The other is much more general and relates to the proper strategy for the United States to follow in trying to reduce the nontariff measures of other countries that either impede our exports or increase our imports.

The portion of the CBO paper that seems to have received the most attention deals with the implications of the Tokyo Round tariff reductions on employment in various industries, in different states, and in major labor-skill groups. The figures on these effects that the CBO survey cites are ones that I calculated in 1975 for a study where I tried to estimate the initial impact-effects on employment of a multilateral tariff reduction of 50 percent. The main conclusion I would draw from my results is the surprisingly small total and distributional effects of a duty cut of this magnitude. For example, my calculations indicated a net impact-effect on total employment of only −15,000 jobs or about two one-hundredths of 1 percent of the labor force. The distribution of the −15,000 jobs across states is such that no state loses more than 2,500 jobs and none gains more than 870 jobs. In view of the facts (1) that my estimates are based upon a 50 percent general duty reduction rather than the reduction of about 35 percent which the tariff-cutting formula finally agreed upon yields; (2) that some items included in my calculations have been excepted from duty cuts or are now subject to quantitative import restrictions; and (3) that the cuts will be phased over an 8-10 year period, it seems to me that the estimates should be very reassuring for any legislator concerned about the employment impact in his area. Unfortunately, the CBO survey did not report the trivial magnitudes of the figures.

The same conclusion holds with respect to the impact of the duty cuts on various skill groups in the labor force. Obviously, employment will tend to rise in industries where we have an export surplus and fall in the ones where we have an import surplus. Since the basis of the comparative advantage of the United States in manufacturing is our highly skilled labor force coupled with our ability to create new technology, those industries utilizing relatively large amounts of highly skilled and research-oriented labor are the ones that benefit the most. Industries that tend to face some adjustment pressures are those that rely heavily on semi-skilled and unskilled labor. But again, we are in most cases talking about very small numbers.

Since completing the employment-impact study, I have carried the analysis a step further by calculating the effects of the cuts on U.S. living standards. In these estimates I take account both of the income benefits from lower import prices and the income losses due to the temporary unemployment caused in some industries. Again the total effects are fairly small, but the income benefits were 28 times as large as the labor adjustment costs.

The proper interpretation in my view of the economic effects of the upcoming tariff reductions is that they provide an almost ideal way of enabling the labor force to move into higher paying jobs. Continuing to keep part of the labor force in industries that cannot compete effectively either with similar foreign industries or our own export industries simply condemns future generations to low paying jobs. However, we must also be highly sensitive to the severe adjustment costs that can be imposed on particular groups of workers and on particular industries as an economy tries to take advantage of its higher income-earning opportunities. With tariff reductions, in contrast to most technological changes, one is able to predict fairly well just where the adjustment pressures will occur and therefore take measures that minimize the costs of raising the country's standard of living.

The second subject that I would like to comment upon is the proper approach towards trade policy for the United States to follow. Presently there seems to be a considerable divergence in views on this matter among trade experts in such parts of our economy as Congress, the Executive Branch, and the academic community. Members of Congress generally believe that trade economists with an academic background base their advise on assumptions which are quite irrelevant for the real world today and that government bureaucrats are much too soft and inefficient in dealing with other countries on trade matters. Academic economists, on the other hand, tend to regard Congressional views on trade issues as dominated by parochial pressure-group interests and think that administrators in the Executive Branch too often sacrifice sound economic principles for vague and unsubstantiated foreign policy considerations. The government bureaucrats, of course, believe that they are the ones who see the true picture; academics and members of Congress simply do not have to deal with all sides of an issue as they do. While we probably can never get a consensus among these three groups, to say nothing of the several other groups purportedly wishing to further the national interest in this area, we should at least try to understand why and where we disagree.

First, there is not, I think, a great deal of difference in views among American trade experts as to the actual institutional nature of the world trading conditions. All recognize that we live in a world of big governments, big businesses, and large labor organizations where complex collusive as well as competitive relationships exist among these three groups. Moreover, actual economic conditions are pervaded with all sorts of imperfections, rigidities, and uncertainties. Furthermore, U.S. trade experts generally believe that most foreign governments intervene in their private export and import sectors in both a more supportive and more regulatory manner than the U.S. government does. Moreover, when our government does intervene, it is in a more open and less discriminatory way than other governments. It should be pointed out, however, that representatives from these other countries usually view the same world in quite a different manner. Whereas an American's picture of international competition may be that of the small U.S. textile or shoe firm having to cope with foreign firms that are supported by special government tax breaks, borrowing privileges, market aids, etc., a foreigner's view of international economic competition is likely to be that of large U.S. corporations who dump their second-rate technology in his country, use heavy-handed tactics to obtain special privileges from his government, exploit his natural resources, upset his cultural traditions, and rely on the military and economic power of the U.S. government to gain domination of his markets.

Another area where the differences in views among U.S. trade specialists within Congress, the Executive Branch, and academia are ones of emphasis rather than substance is what the objective of U.S. trade policy should be. All are interested in promoting the collective welfare of U.S. citizens. However, some differences in policy recommendations arise among trade experts in these groups because of differences in their time horizons and policy frameworks. For example, trade experts outside of government tend to place more emphasis on what economic conditions will be, or should be, 10 or 20 years down the road. Moreover, they tend to confine their perspective to economic considerations. Trade experts in Congress and the Executive Branch, on the other hand, tend to adopt a shorter-run viewpoint, with those in Congress perhaps putting the greatest emphasis on the next year or two. Furthermore, experts from these latter groups often regard trade policy as simply one of several means of affecting U.S. foreign policy. They are less hesitant, for example, to use trade policy to affect another country's human rights policy or its political policies towards a third country than are most academic trade economists.

While there are some differences in emphasis among U.S. trade experts as to the nature of the economic world in which we are operating and what our objective should be, they are not enough to account for their differences in recommendations on trade policy. More must be involved. To get at some of these additional differences, consider how one might respond to a situation where a foreign government simultaneously undertakes certain nontariff measures that uniformly impede all imports into the country and subsidizes all exports from the country. Obviously, these actions tend to increase the country's exports and decrease its imports. If, however, a system of flexible exchange rates exits as these restrictive and subsidizing measures are being introduced, the country's currency will appreciate so that both the impeding effect of the import restrictions and the promoting impact of the export subsidies are entirely offset. In other words, though the country has adopted policies that are inconsistent with usual standards of "good" international behavior, they have been entirely offset by exchange-rate changes. When some economists say that one need not be concerned about what other governments do in the trade area and that we should not retaliate in kind, this must be the type of situation they have in mind.

But suppose we complicate the picture by first imagining that the subsidizing country intervenes in the exchange market to prevent its currency from appreciating. The reason they might do this is because of the existence of domestic unemployment and idle plant capacity, and the wish to use trade and exchange-rate policies to restore a greater degree of full employment and capacity utilization. This could well be preferable to domestic fiscal measures, since greater domestic spending by the country's own citizens may not be directed at the industries most in need. If the countries trading with the subsidizing nation are also faced with employment and capacity-utilization problems, the actions of this subsidizing nation can further reduce employment and income in these other countries. So this is a case where a passive, hands-off policy in response to foreign trade distorting measures does involve a significant cost.

Consider another possible scenario. Suppose the trade-distorting country does not restrict all imports and subsidize all exports but concentrates on a small number of import-competing and export industries. Also suppose that the country does not interfere with the exchange-rate mechanism and that this mechanism works well to restore balance-of-payments equilibrium. The outcome of these policies is likely to be that unemployment is reduced in the country's protected and subsidized industries but slightly increased in all other industries. Similarly in countries trading with this nation, unemployment will increase in the industries producing goods subject to higher foreign tariffs and greater subsidized imports and increase in most other sectors. In other words, there is likely to be a redistribution rather than an overall change in employment in the various countries. However, this redistribution is likely to be bitterly resented in the countries having to accept an increase in subsidized imports and reduction of exports in the product lines protected abroad.

It seems to me that these last two cases illustrate the type of actions abroad that cause members of Congress to become very concerned about our trade policy. The first tends to decrease total employment in all sectors in this country whereas the second imposes a heavy burden on particular industries. To be told that neither should occur since the first action is inconsistent with general IMF principles and the second with GATT rules merely causes more concern, since we all know that in fact such actions do take place in spite of the existence of these organizations. Nor can a legislator be expected to be content with the explanation that these actions are likely to have only temporary adverse effects, since the system eventually adjusts. Thus, again and again we hear members of Congress calling for such "get tough" policies as a general import surcharge and the widespread use of countervailing duties. They find it difficult to understand why trade experts in the Executive Branch as well as in the academic community fail to join them in recommending this policy approach.

Why is it that Administration officials over the years have been reluctant to follow this course, even though they have the domestic authority to do so? The main reason seems to be the absence of any clear-cut international authority for doing so and thus a concern for the consequences of taking such action unilaterally. For example, while domestic subsidies can have effects that are very similar to open export subsidies, the GATT rules on this subject are vague and the enforcement mechanism is weak. If we begin to follow a standard of countervailing that is not accepted by most other countries, we risk retaliatory measures from the European Community, Canada, Japan, and some of the developing nations. Many officials in these countries truly believe that we are among the worst offenders in the NTB field and are only too anxious to initiate countervailing actions of their own. For example, they tend to believe our entire technological superiority id due to various past and present government subsidies and might welcome the opportunity to keep out our high technology goods in order to develop these industries themselves.

The possible consequences of a situation where all the major countries follow a "get tough" retaliatory policy are thus such as to make officials in the Executive Branch reluctant to pursue such a course. They fear that the United States might lose its leadership role in international economic affairs and force the non-Communist world into an even greater number of inward-looking blocs than now exist. Furthermore, since international trade is absolutely vital to some of these countries, they argue that one risks political adventures of a kind that may greatly increase world political instability. Thus, most Presidents have been hesitant to follow a "get tough" policy not because they are somehow misguided or indecisive but because they firmly believe the risks to the welfare of U.S. citizens is not worth the possible benefits. Academic trade specialists focus less on the possible unfavorable political outcome and more on the adverse economic effects this strategy can have on the country.

Of course, legislators are also aware of all of these arguments. Many would maintain that the risks are vastly exaggerated and the benefits very considerable. Letting other countries know in a decisive yet fair manner that the United States no longer can serve as the world's dumping ground will, in their view, not lead to massive retaliation but to greater willingness by others to enter into detailed, enforcible international rules of "good" behavior.

While considerable disagreement exists on the merits of a "get tough" approach, most trade experts now seem to agree that a policy of passively accepting most of consequences of trade-distorting actions is no longer appropriate for this country. During the 1950's and early 1960's the United States did in fact tend to follow this policy as a form of economic aid that strengthened our political alliances. However, for the United States, these decades were ones of high economic growth coupled with near full employment and only moderate inflationary pressures so that the economic costs were modest. However, more and more countries have learned how to initiate with various government aids successful export-oriented industrialization efforts based on their low-wage, efficient labor force. At the same time the U.S. economy has become less dynamic and more inflexible. Thus, following a course of beneign neglect toward the nontariff measures of other countries now risks sudden surges of imports in selected product lines that can cause considerable unemployment and earnings losses in domestic industries producing the same products. The resulting hardships are very properly regarded as politically intolerable by the Congress and the President.

The alternative to these two extreme policy positions is the one we have been pursuing in the Multilateral Trade Negotiations. This is to seek international agreements on a stricter interpretation and enforcement of existing GATT rules on nontariff trade barriers as well as on extensions of these rules to new areas of concern. Of course this approach involves risks too. As in most negotiations, others may have very different views on what should or should not be permitted as "good" international behavior and how any new rules should be enforced. We may find that after a long period of difficult negotiations very little is actually changed and we still feel we are being treated unfairly. But in view of what can only be regarded as a series of remarkable accomplishments in the nontariff field by our negotiators, it seems to me that pursuing the international route to reducing the nontariff trade distortions that are especially harmful to the United States is very much worth these risks. The routes of taking unilateral action or of ignoring these distortions are in my view not appropriate ones for a major democratic international power operating in an increasingly interdependent world.

Whether the new GATT rules and procedures in fact satisfy our objectives is a matter that will be determined not so much by whether the new codes are accepted but by how vigorously their implementation is pursued. In this regard, one cannot help but be somewhat concerned about some of the recent efforts to minimize any economic adjustment pressures in this country. To other countries, it sometimes appears that all the United States is trying to do is to increase its exports to others without accepting more exports itself. But trade is a two-way street; one cannot expect others to accept more of our goods unless we buy more of theirs. Thus, the developing countries wonder why they should open up their markets to more of our capital goods and agree not to limit their exports of essential raw materials when they see us introducing more restrictions on imports of products where they have a strong export capability. In other words, we cannot expect others to take the new codes seriously unless they believe we are willing to adapt to the new realities of world resource allocation.

At the same time we too have abundant evidence that many other countries are reluctant to open many of their markets to the goods we can produce best. Thus, the challenge that lies ahead for all nations in implementing the new agreements is to devise means of adjusting to the pressures for economic charge in a manner that achieves the higher living-standard potential for all without, however, imposing undue hardships on particular economic groups within both developed and developing nations.

Senator STEVENSON. Thank you, sir.

We will continue with the testimony. Then I would like to come back to ask both of you some questions.

Dr. Cline.

Dr. CLINE. Thank you very much, Mr. Chairman, for the opportunity to appear again before this committee. The central point of my statement is that there are substantial economic benefits for the American consumer and for the U.S. economy as a whole from the Tokyo Round of trade negotiations and that these benefits can be achieved at very small costs in terms of economic adjustment.

I might point out that the benefits are going to be smaller than they might have been because we have already paid the political price for the passage of this legislation, in particular, in the textile sector. It is my understanding that, in order to disarm the opposition, there have already been struck agreements that would significantly reduce the growth of textile quotas in the future. I might add that this particular measure represents discrimination against the developing countries, which are the ones that supply these articles under quotas, in favor of the European countries that would benefit from reduced tariffs—in those areas where tariff would be reduced.

That being said, despite these limitations, I think that the liberalization achieved in the Tokyo Round is an important accomplishment. Tariffs will be cut by about 30 to 35 percent. There will be new nontariff barrier codes that will liberalize trade in an area that is increasingly one of severe protection.

The first main subject of my testimony is the impact of the negotiations on U.S. exports. In my statement before this committee last year, I presented estimates, based on the Brookings Institution study, of the impact of negotiations on U.S. exports. These estimates were based on a computer model that incorporates detailed information on tariffs and trade for the United States and for 10 other major negotiating parties. If one updates those estimates to 1978 trade value levels, the increase in U.S. exports that one could now expect from the so-called Swiss formula, which is the central negotiating formula, will be about $4.6 billion annually. These exports would be primarily to markets in the European community, Canada, and Japan, but we would also be increasing our exports to the developing countries as they earn more foreign exchange from their new export opportunities and in turn, buy more from us.

The productive sectors that would have the largest export increases would be grains, chemicals, paper products, machinery and electrical equipment, transportation equipment, and precision instruments. My written testimony gives more illustrations of products and markets that would be affected. Among them, we would be exporting more aircraft to Japan and the Common Market, computers and earth-moving machinery to EEC and Canada, and photographic film to all three markets.

My written testimony also mentions areas of exceptions both for the United States and abroad. The United States will be excepting from tariff cuts sensitive sectors such as textiles, apparel, leather goods, footwear, television sets, and specialty steel. The exceptions to the tariff cuts being taken by our trading partners do not show any overwhelming pattern of concentration by sector except for the fact that they, like we, are taking exceptions in textiles. Despite the exceptions both sides have taken, the tariff cuts in the Tokyo Round will be large. They will be comparable to the depth of the tariff cut accomplished in the Kennedy Round of negotiations which was the most important round of negotiations in the postwar period until now.

As for the nontariff barrier codes, it seems to me that these, too, will open up export markets for the United States. The Government procurement code could open up foreign markets on the order of $25 billion. The code on standards should help American products because standards have increasingly been used to screen out technologically sophisticated products from the United States, and the United States has a comparative advantage in this area.

The code on subsidies and countervailing duties should provide some additional assurance to agricultural exporters that they will not lose their traditional markets to subsidized exports from the Common Market. I think in this case, as in all of the nontariff barrier codes, the new provisions of the codes for multilateral panels, and sanctions, put more teeth in these nontariff barrier codes than has existed in the past. In other words, in the past, the GATT law as such had many of these same provisions, but it did not have the apparatus for enforcing them that the new codes will provide.

Let me now turn to the Congressional Budget Office report. In my view, this report in many ways is technically sound. I do believe that the report has been widely misinterpreted, however, especially in its assessment of the employment impact of trade liberalization. The report has been construed as saying that trade liberalization will cause significant employment problems in the Northeast. In fact, the CBO report itself states that any job losses from liberalization will be small.

In the particular section of the report that talks about the State impacts, the report gives a listing of several States where job losses through increased imports would exceed job gains from increased exports. Unfortunately, at that particular point, the report does not state immediately that these net job effects will be extremely small. By failing to make that statement at that particular point in the report, the study leaves itself open to misinterpretation that there could be significant employment problems in these States.

In short, the problem is one of misleading packaging, not one of inaccurate content. I think the report should have been more emphatic, additionally, in its description of the sensitive sectors and its treatment of the fact that these sectors are being essentially kept out of the liberalization. As Professor Baldwin said, the sensitive sectors such as textiles, footwear, leather products, and utensils, have largely had exceptions from the tariff cuts, or else, as in the case of textiles, they are controlled by quota regimes that, for most of the suppliers, make the tariff cut meaningless.

Another point that I would make on the CBO study is that it tends to understate the economic benefits from trade liberalization.

I would emphasize the fact that liberalization is an important source of reducing inflationary pressure in our economy, and thereby making it possible to pursue more expansionary policies than we otherwise would and achieve macroeconomic gains.

I have more specific comments in my written testimony. One of these comments that I would emphasize is that the particular figure for economic benefits from the negotiations that the CBO report cites from the Brookings study, $1 billion a year, refers to a concept which considerably understates the total economic benefits. It's a concept of static economic welfare. It excludes the important dynamic effects of increasing investment, technical change, economies of scale, and it excludes the macroeconomic benefits from more expansionary policies made possible by anti-inflationary effects.

When these effects are included and when one uses a 1978 trade base to obtain current figures, my estimates would be that the economic benefits to the country now just from tariff cuts alone would be about $4.5 billion annually.

Most exerts agree that the nontariff barrier agreements could be even more important. So if one considers nontariff barriers as well, one would have to say that the economic benefits should be somewhere on the order of $10 billion annually or, in other words, 10 times the figure that the CBO cites.

In summary then, in my view, the CBO report tends to understate the economic benefits from the Tokyo Round, and its presentation leaves the erroneous impression that many States and industries would suffer severe job losses.

The other report which we are looking at today, the Jones report, from a task force for the Ways and Means Committee, in my view does have a number of very useful discussions of the Japanese-United States trade problem. I think the report is excellent in recognizing that the United States-Japan trade problems should not be dealt with by imposing special trade barriers against Japan. The report also directly recognizes that the problem is caused in large part by the fact that exchange rates take a long time to have their effect on trade.

The report does have some weak points. Its suggestion that Japan is frustrating the exchange rate changes, is not well supported. Neither is its suggestion that the exchange rate effects and their benefits are not being passed through to the Japanese consumer. Nor is the tone of the entire report that Japan is steeped in nontariff barriers very well substantiated. The report itself mentions that Japan has taken many liberalizing measures in the last few years.

The report also has a tendency to focus just on the bilateral U.S.-Japan trade balance when it is generally accepted that one has to look at Japan's worldwide balance, not just the U.S. balance. This flaw is especially misleading in the treatment of the Korean trade situation. I think the report also could have placed more emphasis on the fact that Japan's recent surpluses have been primarily due to slower growth in Japan and, by the same token, faster growth in the United States.

Nevertheless, I think that the report does contain a number of very useful insights into the relationship of the United States and Japan in the world economy.

I would say that, if properly read, both the CBO report and the Jones report represent cases in favor of passage of the Tokyo Round package, quite the contrary to the apparent interpretation that at least some people are putting on these two studies.

[The full statement follows:]

Statement by William R. Cline, Senior Fellow, The Brookings Institution

THE TOKYO ROUND

It is a pleasure for me to appear once again before this Committee. Over the last year the final results likely to emerge from the Tokyo Round of trade negotiations have become much more clear. In general, I remain convinced that liberalization achieved in these negotiations will represent substantial economic benefits for the American consumer and the U.S. economy at only limited costs of economic adjustment. The benefits will be smaller than they could have been, because of the political price paid for disarming opposition to the trade pact. In particular, the administration appears to have a major restrictive action in textiles trade, slowing down the growth of quotas (from their 6 percent normal rate under the multifibers agreement to as low as the rate of domestic market expansion, or about 2 percent annually) and providing for the reduction of unused quotas (setting the stage for a successive tightening of quotas whenever import demand falls in recession years). This protection appears to have been unnecessary in economic terms, because textiles already enjoy a regime of quotas that would make tariff cuts inoperative for the bulk of textile imports, and many of the U.S. exceptions on tariff cuts were concentrated in textiles as well. However, it is conceivable that the political risk of failure of the entire Toyko Round package would have been high in the absence of these concessions to the textile industry.

Despite the limitations imposed on liberalization, the Tokyo Round represents an important accomplishment. Tariffs will be cut by an estimated 30 to 35 percent, and new non-tariff barrier codes will provide the basis for an attack on the increasingly important protective devices.

The negotiations are coming to a close at an awkward time, when the U.S. trade deficit is large, and when some advocate special restrictions against Japan because of its large trade surplus. In point of fact, exchange rate changes in the last year, and the relative slowing down expected for the U.S. ecomony, should bring considerable progress in reducing the U.S. trade deficit (partly offset by higher oil prices). The most recent trade balance figures (for February) show a sharp improvement in the U.S. trade balance. As for Japan in particular, there have already been some meaningful special liberalization agreements, including a doubling of the Japanese beef imort quota; a threefold rise in its quota for imports of oranges; agreements to simplify inspection procedures (for example, for automobiles), and special efforts in a U.S.-Japan Trade Facilitation Committee. Moreover, the Japanese trade surplus appears to be declining.

My central comments today, however, will focus on the broader implications of the tariff and non-tariff agreements for U.S. exports. In addition, in response to the Committee's request, I will comment on two recent studies on the trade negotiations by the Congressional Budget Office and by a task force of the House Ways and Means Committee.

TRADE LIBERALIZATION

In my testimony before this Committee last May, I presented estimates (based on the Brookings study on the Tokyo Round) of the impact of tariff cuts on U.S. exports by 21 major product categories, in values calculated from a 1974 trade base. The estimate was that the expected "Swiss Formula" tariff cut would raise U.S. exports by about $3 billion using 1974 values. If these estimates are updated to 1978 values by considering the growth of exports and imports in each broad product group, an updated figure would be that exports should rise by approximately $4.6 billion from the "Swiss Formula" tariff cut. After allowing for product exception (which are expected to cut the average tariff cut from a depth of 40 percent to a depth of 30-35 percent), the approximate estimate would be export gains of slightly under $4 billion (in 1978 values). The principal markets for these export gains would be the EC (41 percent), Canada (26 percent), Japan (14 percent), the developing countries (10 percent), and other industrial countries (9 percent).

The largest net export increases from tariff cuts abroad will be in grains, chemicals, paper products, machinery and electrical equipment, transportation equipment, and precision instruments. Of these, the largest would be machinery and equipment (with an increased trade balance of over $1 billion) and chemicals (with an increased trade balance of about $500 million).

More specifically, foreign tariff cuts would cause significant increases of U.S. exports of aircraft to Japan and the EC; electronic measuring instruments and automible parts to the EC; computers, earth moving machinery, general chemicals, and internal combustion engines to the EEC and Canada; and photographic film, radio and television transmission equipment, tubes and transistor, soaps, and varnishes to all three markets.

Exceptions from tariff cuts will be taken by the United States as well as our trading partners in sensitive sectors such as textiles, apparel, leather goods, and footwear. The United States is also likely to take exceptions in other sensitive products such as television sets and specialty steel. Principal exceptions taken by our trading partners are likely to include lumber (EC, Japan); paper (EC, Japan); chemicals (EC, Canada); drugs (Canada); non-ferrous metals (EC, Japan, Canada); electronics and telecommunications (EC); and construction, mining, and agricultural equipment (Canada).

Despite the exceptions on all sides, tariff cuts in the Tokyo Round will be significant, comparable in their depth to the average cuts of the Kennedy Round (although starting from a lower tariff level).

CODES ON NON-TARIFF BARRIERS

The major innovation of the Tokyo Round, however, is the development of a series of codes limiting non-tariff barriers. These codes will open up existing trade practices and, perhaps more important, establish ground rules that will minimize the chance of trade wars in coming decades. Policing international trade is becoming increasingly important, given the recent drift toward protectionism (following a surge of trade liberalization for anti-inflationary purposes in 1973-74).

The NTB codes should boost U.S. exports in a number of areas. The government procurement code should open up to competitive bidding foreign government markets of over $25 billion, although the final negotiations on the inclusion of key entities (like Japan's Nippon Telephone and Telegraph) are not yet complete. Because the United States has a comparative advantage in technologically sophistcated products often needed by governments, U.S. export potential in this area should be strong.

Similarly, the new code on standards should help American exports, because product standards have often been used to screen out imports of technologically sophisticated products. In the past, U.S. exports have been hindered by the system of certification for electronic equipment in the EC, inspection and safety requirements for automobile and consumer appliance imports into Japan, inspection procedures for pharmaceuticals in France, the permissible size of beverage containers in the EC, and other technical standards for citrus fruit in Japan and wood products in Japan and Canada. The new code should reduce or eliminate barriers such as these, and prevent the proliferation of similar barriers in the future.

The code on subsidies and countervailing duties will help the United States primarily on the import side, by bringing discipline into international trade increasingly affected by direct and indirect government subsidies. On the export side, the new code should provide some assurance to U.S. agricultural exporters that their traditional markets in third countries will not be taken over by subsidized exports of surplus agricultural commodities from Europe. In addition, if the subsidies code is taken at its face value, it contains a radical concept favorable to U.S. exports: action could be taken to remedy "serious prejudice" to U.S. exports caused by subsidies given to industries abroad for import substitution on their home market. Still another aspect of the code is that it will limit export subsidies by newly industrialized countries. Although I have doubts about the economic wisdom of this provision (because these countries often need subsidies to offset disincentives to exports), it may act to make U.S. exports of manufactures more competitive with those from newly industrialized countries in third country markets.

The safeguards code probably will affect U.S. imports more than U.S. exports. The code would increase the discipline on safeguard protection, which has sometimes been applied in Eurpoe in ways that tend to divert a surge of imports into the U.S. market. The safeguards code stands in doubt, however, because the developing countries have rightly refused to go along with the European insistence on the right of unilateral imposition of safeguards on individual suppliers without multilateral approval. (The likely result of this approach—"selectivity"—would be to screen out imports from developing countries.)

In summary, the non-tariff barrier codes represent a major step forward in opening foreign markets for U.S. exports, and perhaps more important, they will represent a bulwark against the future closing of these markets through increasing protectionism that might otherwise occur in the absence of these codes.

THE CONGRESSIONAL BUDGET OFFICE REPORT

The paper recently prepared by the Congressional Budget Office[1] is in many ways a technically sound assessment. Unfortunately, it has been interpreted as saying that trade liberalization will cause significant employment problems in the Northeast, and that overall the benefits from liberalization are minor.[2] The CBO report actually states that any job losses from liberalization will be small (p. 30, p. 47). In the section dealing with geographical impact, however, the report gives a listing of several Northeastern states where jobs losses would exceed job gains (p. 24), and by failing to state immediately that the net changes are inconsequential, the report leaves itself open to the interpretation that significant employment problems could affect these states. In point of fact, using Professor Robert Baldwin's estimates (the same ones used by the CBO), even for the 10 states cited by the CBO as losing the most jobs in relative terms, the estimated gross loss of jobs to increased imports would be less than one-fifth of one percent of employment, and if export gains are counted in, the estimated net job loss is a negligible three one-hundredths of one percent. Indeed, the Brookings study frequently cited by the CBO concludes that the economic benefits of tariff liberalization would be eighty times as large as the labor adjustment costs.[3] The Northeast would participate in these benefits, and therefore even the Northeast will be far better off with trade liberalization than without it.

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[1] Congressional Budget Office, "U.S. Trade Policy and the Tokyo Round of Multilateral Trade Negotiations" (Washington, D.C.: March, 1979).

[2] See for example the article headline "Study Says Trade Pact Could Hurt Northeast," New York Times, March 11, 1979, p. 1. The Times has compounded its misinterpretation by building upon it as the basis for a call for special treatment for the Northeast. (See the editorial "Free Trade's Winners and Losers," New York Times, March 22, 1979, p. A22.)

[3] W. Cline, N. Kawanabe, T. Kronsjo, and T. Williams, Trade Negotiations in the Tokyo Round (Washington, D.C.: Brookings Institutions, 1978), p. 130.

The CBO report also lists industries that would be most seriously affected by liberalization, citing textiles, footwear, leather products, utensils, steel products, and radio and television sets. Yet the report fails to state with sufficient clarity that these sensitive sectors have been largely exempted from the liberalization by special exceptions and by quota systems that make tariff cuts meaningless. Thus, the report is misleading when it says "to estimate how large an increase in U.S. textile imports might result from textile tariff reductions . . . is beyond the scope of this paper" (p. 23). The fact is that (a) the existing regime of quotas on textile imports, (b) the new tightening of those quotas, and (c) the high frequency of U.S. "exceptions" to textile tariff cuts, means that the net effect on textile imports is likely to be minimal (or conceivably even a reduction of imports from levels to which they would have grown under previous quota growth provisions).

Finally, the CBO is too cavalier in treating the economic benefits from trade liberalization as small (p. 32, p. 47), although the report does acknowledge that the benefits would far outweigh the labor adjustment costs (p. 21). The report states that "domestic fiscal and monetary policies will swamp macroeconomic effects of the negotiations * * *". To be sure, any major error in domestic macroeconomic policy could cause damage far in excess of the benefits from trade liberalization. But the whole point is that trade liberalization can provide the country with a "windfall gain," raising its income above the level that can be achieved even after the very best possible domestic macro policies are identified and followed. Despite the best efforts of U.S. economic policy-makers at resolving the problem of "stagflation," we continue to face high and accelerating inflation domestically. Freer trade is one of the few ways left (if not the only way) to moderate inflation without risking significantly increased unemployment. The CBO report points out that trade liberalization would cut half a percentage point off the consumer price index, and considers this impact small, in part because it is spread over several years. However, this estimate excludes the impact of non-tariff barrier liberalization. Moreover, half of one percentage point is not small. In order to reduce inflation by half a percentage point it is generally necessary to raise unemployment by 1.5 percentage points, sacrificing 1.4 million jobs.[4] To the extent that spreading liberalization over several years delays the antiinflationary impact, the United States could accelerate the phase-in period of liberalization in order to obtain earlier results.

On the specific estimates of liberalization's economic benefits the CBO report also tends toward understatement. It cities a figure of $1 billion in U.S. benefits (p. 20) from the Brookings study. However, that figure was the estimate of static welfare estimates only. It is well known that the dynamic effects of increased investment, technical change, and economies of scale far exceed the "static" benefits of lower prices to consumers. Moreover, there are macroeconomic benefits achieved when the country can follow more expansionary policy in view of the relief to inflation provided by import liberalization. The Brookings study also reports estimates for total benefits, with these various dynamics effects included. In view of 1978 trade values, and using the "Swiss Formula" for tariff cuts, total economic benefits to the United States should be about $4.5 billion annually from tariff cuts alone.[5] If one accepts the almost universal view that the non-tariff barriers codes are more important than the tariff cuts, then there should be an additional economic benefit of at least comparable size, raising total economic benefits to at least $10 billion annually (or ten times the specific figure for 1974 static welfare gains from tariff cuts alone, the figure cited by the CBO).

In summary, the CBO report tends to understate the economic benefits from the Tokyo Round. Moreover, the format of its exposition has led to widespread interpretation of the report as saying that many states and industries would suffer several job losses, even though if one looks carefully the report does qualify that any such losses would be very small.

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[4] See for example George L. Perry, "Slowing the Wage-Price Spiral: The Macroeconomic View," Brookings Papers on Economic Activity 2 (1978), pp. 259-91.

[5] Based on the ratios of trade creation and static welfare gains under the Swiss Formula to their magnitudes under the full U.S. authority cut, the U.S. Welfare gains for static and dynamic benefits would be $1.95 billion annually in 1974 values. Allowing for the macroeconomic benefit of reduced unemployment achievable because of the anti-inflationary impact, the total benefit would be one-third higher, or about $3 billion. Calculated from Cline et. al., pp. 78, 82. Updating to 1978 values (by expanding for the 50% increase in export values) the 1978-based estimate would be approximately $4.5 billion in annual economic benefits.

WAYS AND MEANS TASK FORCE REPORT

The recent report[8] of the task force led by Representative James R. Jones is another study that contains many thoughtful analyses but seems to go astray in some of its policy conclusions. To begin with, on the basis of your letter inviting me to testify, Mr. Chairman, I understand that the Jones report is being interpreted as raising questions about the effectiveness of the MTN agreements in raising U.S. exports. Yet it is precisely the type of barriers enumerated in the report that the new codes on non-tariff barriers will help dismantle. The report mentions problems with Japanese application of technical standards; the new standards code should help. The report mentions exclusion of U.S exports from Japanese government purchases; the new government procurement code should help. The report mentions Japanese subsidies to offset the appreciating yen; the new subsidies code should help.

The report itself is highly commendable in its recognition that special trade barriers against Japan would be the wrong way to deal with Japan's trade surplus (p. 3). It recognizes that exchange rate changes take many months to have their desired trade-correcting effect, and that premature action from impatience would be a mistake. The report presents several statistical indicators showing that the Japanese surplus is declining.

There are some questionable elements of emphasis in the report, however. It suggests that Japan is frustrating the intended effects of yen appreciation by offering offsetting loans and subsidies to affected businesses. Yet the amount cited ($1 billion) is minimal relative to Japan's overall export of more than $80 billion. Again, the report suggests that the consumer is not receiving the benefit of a stronger yen because businesses do not pass through lower import prices. As evidence, the report cites the divergence between a rising consumer price index and a wholesale price index that is actually falling in absolute terms. This evidence proves very little. The CPI traditionally rises faster than the WPI in Japan because the CPI includes services, where productivity growth is low. Indeed, the declining WPI may be construed as evidence that lower import prices are actually reaching Japanese businessmen who import raw materials and machinery. As the report itself states, consumer goods represent a small share of Japan's imports in any event.

The tone of the report is that Japan is replete with non-tariff barriers. Yet the report itself enumerates the many special liberalizing measures taken by Japan in recent years (which demonstrate that the rise in Japan's trade surplus is *not* due to a rise in protection). Moreover, the 5 (out of 16) cases forwarded to the Japanese by the Trade Facilitation Committee and not favorably resolved (pp. 22–25) hardly read as compelling evidence of trade barriers.

At a broader level of economic analysis, the report can be faulted for its focus on bilateral trade balances (U.S.-Japan, U.S.-Korea). Most economists agree that a country's external position must be assessed by examining overall trade and current account, not bilateral balance with individual nations. Similarly, the report places insufficient emphasis on the fact that Japan's recent surpluses have been attributale to slow domestic growth (and fast growth in the United States) rather than to a discriminatory trading regime. Another macroeconomic point is that Japan may be expected to run some trade surplus over the long term, in order to finance an outflow of long term capital that is beneficial for investment and growth in developing countries.

Despite these limitations, the Jones report, if carefully read, is a highly useful and frequently perceptive analysis of U.S.-Japan trade relations.

Senator STEVENSON. Thank you, sir.

You say that the CBO report is technically sound. Maybe that is the explanation for some of its questionable conclusions. One of those States that is supposed to suffer a net loss of employment is my own, which I think I know better than CBO does. Illinois is the largest net exporter of all the States.

I don't think there is anybody who understands Illinois who doesn't feel strongly that it will be one of the principal beneficiaries from approval of this round. That goes for jobs as well as income.

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[8] U.S. House of Representatives, Committee on Ways and Means, Task Force Report on United States-Japan Trade (Washington, D.C.: U.S. Government Printing Office, Jan. 2, 1979).

Doesn't the prediction of consequences require some assurance that neither you nor CBO nor anybody can confidently make? Dr. Baldwin pointed out that benefits from the nontariff cuts are going to depend, to some extent, on the enforcement of the nontariff codes.

But isn't it also true that we can reduce tariff barriers and nontariff barriers through codes and through their enforcement, and it will still avail us little, if we are not competitive, if our economy suffers declining rates of productivity growth and structural rigidities which prevented adjustments not only to imports but to marketing opportunities in the world? In this world competitiveness turns on the political process, the political decisions.

One of you mentioned, I think it was you, Dr. Cline, the CBO comments about the Japanese response to the devaluation of the dollar against the yen.

Well, the Japanese won't be our only competitor in this world. Advanced LDC's are coming onstream now and selling steel and television to the Japanese. They are going to do everything in their power to overcome the appreciation of their currencies. And more so as the cost of their imported fuels goes up.

Now, that is more of a statement than a question. But the bottom line is, aren't these predictions worthless? Won't the results depend on whether we get geared up now and go out to compete in an environment that will provide us with opportunities, but with no assurance that we will take advantage of them?

Dr. BALDWIN. I wouldn't go so far to say they are worthless. They are estimating efforts that have to be taken in the context in which they are made. We in the social sciences, and economics in particular, are trying to make more exact predictions by using simple models and actual data. We know we are still in a very crude state of our science.

That doesn't mean that we should stop and wait until our analyses are perfected. We should publish them but also make sure that a number of alternative studies are available to serve as a check on the results of any one study.

Moreover, you don't make policy decisions on the basis of such studies alone. They should serve only as one bit of information given to a policy maker. He should consult his own experts as well as knowledgeable people in business and labor about relevant facts bearing on a particular situation.

But you are right, these studies have been misinterpreted.

Senator STEVENSON. Maybe what he ought to do is do what he can to gear the country up to compete in an environment that will give us a greater opportunity, but no assurance that others won't be the ones to take advantage of it.

Dr. BALDWIN. Could I make a comment on your point about competition? There are several levels at which one can address this subject. One is an immediate short-run level, while another is a more basic, long-run level involving many years.

Let me focus on the latter. I have done a lot of work to analyze what the basis is of America's comparative advantage. What are the characteristics of the industries in which we have an export advantage? I have confirmed the result that the basis for our comparative advantage is our ability to undertake rapid technological progress. We see that the industries where we have a high proportion of personnel involved in research and development work are the ones in which we have an export advantage.

It is not because we work harder or are any brighter.

People in the underdeveloped countries can work just as hard and are just as bright as we are. We happen to be fortunate because we have gotten a jump on the rest of the world in developing new technology. We have a private enterprise system which provides incentives to people to develop new technology and we have a tradition of higher education that produces the personnel needed to create new and better products.

In the long run, as your committee has said, we must insure that this potential to come up with new and advanced technology is maintained. I see it being weakened by a certain lack of incentives and I favor more efforts by the government to encourage research and development through higher education. Knowledge creation is the basis for our high standard of living and it is one of our most precious assets.

Other people, however, can copy our new inventions very quickly so that we have to keep coming up with new things. We have to run harder and harder all the time to maintain our advantage.

The second aspect of international competition is that we must learn to adjust our economy by discarding activities that don't seem to offer potential for the future. We must move our resources into the activities that have the greatest potential in terms of exports. You touched on the point in your statement that a danger in our country, as well as in many industrial countries, is that rigidities get built into the system which make it more and more difficult to shift resources around.

Suppose we are successful in exporting. Increasing export activities is going to bid up wages, and this is going to make it more and more difficult for some labor-intensive industries to compete successfully. In other words, the pressure will come from our own export industries as well as from the developing countries. This is going to create more and more hardship in particular industries and more and more pressure for protectionism. But protectionism means that other countries will respond by taking away our export markets.

So we must begin to think about industrial adjustment policies in a serious way. It is not, I think, a politically popular topic since someone is likely to be hurt. But I think we must pay more attention to it. I firmly believe we can devise a policy program so that minimal human hardship takes place. Yet we can shift resources into the expanding sectors.

Senator STEVENSON. Dr. Cline.

Dr. CLINE. I agree with what Professor Baldwin has said. In response to your question about the utility of the estimates models such as the one that we prepared at Brookings and that Professor Baldwin has prepared and the people at Michigan University have prepared, I think they do have a utility. I think that they show the central tendency of what the negotiations will do. I completely agree with the point that, whether the actual results are above that central tendency or below that central tendency will depend on the policies we adopt in this country.

I do think it is important that virtually all of these studies show some central patterns for policy purposes. First of all, they show that the benefits from these negotiations will exceed by far the economic adjustment costs. In the Brookings study, we found that the economic benefits were 80 times as large as the labor adjustment costs. Second, these studies show that labor adjustments that will be necessary are extremely small.

Now I think that one should not expect the trade negotiations to radically increase our trade balance or to radically increase our employment by having a large increase in export jobs and no effect on import jobs. If there were such a result for the United States, then the other trading partners wouldn't agree, because their mirror image would be a severe loss of jobs in Europe or Japan, and a severe trade balance deterioration, say, for Europe.

The whole point of trade negotiations is that there is essentially a balanced effect on increased exports and imports for all parties. By carrying out that balanced agreement, all parties can experience the economic benefits of lower prices to consumers, stimulus to investment, and so forth.

So that I am not sure one should consider as a goal a massive increase in the U.S. export surplus, let's say, or in U.S. job gains relative to job adjustments on imports. One has to expect that the negotiations will be balanced in that regard.

With regard to competitiveness, I think that we have gone through a period in the last few years where there are very severe macroeconomic forces that are eroding our competitiveness. We have had high inflation in this country in the last year or two relative to Japan and Germany. We have had rapid growth at home, while there has been slow growth abroad. This has made it easy to sell to the domestic market and hard to sell to to the foreign market. So that has eroded our export performance. We have had a decline in productivity growth in this country. In fact, in 1978, real GNP per employed worker actually fell. Productivity is, in large part, a puzzle, still. But I think part of the answer is the need for incentives to invest.

In short, it seems to me that there are a lot of U.S. macroeconomic factors that affect our foreign competiveness and that we cannot look strictly to trade negotiations and things such as beating the Japanese over the head as the solution to our competitiveness problem. Instead, to some extent, we must get our own house in order before we can be competitive.

I think one area that does warrant reexamination is export credit. The amount of export credit we are giving through Export-Import Bank is low relative to our export base, in comparison to other countries. We have made some progress in this area because we have apparently convinced the other countries to agree on an interest floor to their loans which is more injurous to them than it is to us. In other words, with a 7-percent floor on interest rates, we have high enough inflation in the United States that 7 percent is an attractive rate, while 7 percent is not an attractive rate for borrowing in marks or yen. So we are making some progress in that area, but I think this is an area worth looking at again in evaluating U.S. competitiveness.

Senator STEVENSON. We will be examining the adequacy of the authority for our credit facilities, including CCC.

I am hopeful that those authorities cannot only be made adequate, especially with a view now to export opportunities in nonmarket countries that didn't exist at the time we established these authorities, but that, made more adequate, they will make it easier for us to negotiate more forceful agreements to restrict export subsidies.

That is one of our objectives. It is not, certainly, to engage in an export credit war, but to put in place agreements with respect to credits that are observed.

Dr. Baldwin, you referred to R. & D. I have another hat, which is as chairman of the Subcommittee on Science, Technology, and Space, where we take the lead on this subject, including the capacity for industrial innovation. I agree with what you say, the criticality of the capacity for technology and basic research.

We also are very concerned by evidence our relative capacity is eroding. That evidence now includes some very objective studies by economists who have attempted to quantify the technological inputs of various economies and have concluded that, in Japan and other countries, including Germany, research is contributing more to the development of new products than it is the United States, where our investment in R. & D. is increasingly oriented to process improvements, as opposed to long-term product level. We will be trying to devise ways of recovering our once preeminent capacity for industrial innovation.

You also mentioned adjustment. Do you think that—I address this to both of you—this trade agreement should be accompanied by new proposals to facilitate trade adjustments, including labor adjustments? Is anything more needed? We have never been very effective in this business, it seems to me. I asked the administration witnesses yesterday if they had anything to suggest. They had nothing to suggest. Do you?

Dr. BALDWIN. I would make the suggestion that we use this as an opportunity to really revamp our whole approach to adjustment systems. However, I am not very hopeful that politically we are ready for the kind of adjustments that I think eventually must come.

I think that more of the same of what we have, such as extending unemployment benefits, doesn't do too much good. It is not going to solve the problem, although it eases it. But it's not adjustment, it's compensation for the period when you are looking for another job. I sympathize fully when it comes to what the labor people say about the present approach.

What I have in mind is programs of structural change that may take, 10 or 15 years, and where some sectors may have to decline in relative or perhaps even in absolute terms. However, we would have plans by which those who are already employed in these sectors could stay on if they wished. They would also be offered some sort of compensation package or early retirement, if they wished to leave the industry. At the same time young people would be discouraged from entering these industries.

These are the people who can best afford adjustment, who can move to other areas, who can get new training and can go into industries that are expanding. Various tax incentives or subsidies would be used to gradually decrease the relative or absolute sizes of these industries. We haven't really accepted the notion that an industry may have to decline. If we look over the trade legislation, it's only in the Trade Act of 1962 that for the first time there is a hint that maybe adjustments should take place. But the kind of adjustment program implemented was mainly one of providing unemployment insurance while the person looked for another job. No real attempt to shift resources out of an industry and provide alternative employment was made under the program. If every time we are under import pressure, we just put on more quotas and restrict imports, we will find as the developing countries get more and more power that they are not going to keep open their markets for capital goods nor raw material supplies unless we open up your markets to them.

Political power will probably be the decisive factor, but we should begin to plan for what kinds of adjustment schemes might be politically acceptable in this country.

Senator STEVENSON. Dr. Cline, do you want to add anything?

Dr. CLINE. I think also that, in a sense, the key to this question is politics. I am struck that in a number of industries we seem to be politically compelled to establish regimes of quotas and almost controlled trade, parceling out the world market. The textile area is the chief example. One wonders whether we are going this direction in steel and other products. I think it would be a high-return investment to have sufficient adjustment assistance in order to calm the political concerns of the people in these industries and their elected representatives, to guarantee that they are not going to be sacrificed and bear the sole burden of adjustment for the country. That being said, I do think that the numbers suggest that we have already made quite an improvement in the adjustment assistance program, and it's not clear on purely economic grounds how much more beefed up a program we would really need.

My understanding is that the adjustment assistance program is running somewhere in the order of $200 to $300 million annually.

And the kinds of figures that come out of the studies we are referring to here today suggest that, at least from the trade negotiations, the numbers of jobs that would be involved from losses to imports, could easily be funded by the existing level of adjustment assistance, and perhaps the entire 8 years' phasing-in program could be covered by maybe only 1 or 2 years' worth of that kind of funding, simply at the numbers of jobs involved and estimated costs of labor adjustment for workers.

So I am not convinced on economic grounds we have a seriously lacking adjustment assistance program. I do think on political grounds we are heading in the direction where we are turning away from the traditional open trading system that has helped this country have a more vital economy than the economies of many other countries in the world. If it is necessary to provide even more compensation to those industries which must adjust in an open trading system, I think it would be a wise investmeant.

So, in summary, I do agree with you that it is a good time to review the adequacy of the adjustment assistance programs.

Senator STEVENSON. What form does our adjustment assistance for workers take now? Does it help in retraining, relocation?

Dr. BALDWIN. They become eligible for the various retraining programs that are in existence once they are accredited as eligible for adjustment assistance.

There are even migration allowances that you can have. Of course, the main aspect of the program is that unemployment insurance is extended for a longer period of time than usual.

Senator STEVENSON. Yes. Does it help match the individual with job opportunities throughout the country beyond training? Identifying employment opportunities for him?

Dr. BALDWIN. There is no specific part of the program dealing with that as far as I know. The Department of Labor does, however, have employment offices, that try to do this for all unemployed workers.

My understanding is that the import adjustment program just fitted in with the regular program dealing with all unemployed workers.

As far as I know, nobody is studying what industries might have to decline in the future. Nor is anyone studying what industries might expand and how can we match jobs in the contracting and expanding industries by training people and moving them to new industries.

Senator STEVENSON. Yes. That is closer to what we are working on in the area of industrial innovation.

Dr. Baldwin, you mentioned the importance of enforcement of the codes. Do you have any observations to offer us about the adequecy of the procedures for enforcement.

Dr. BALDWIN. Let me first summarize a little what they are. Each code will have its own committee of signatories that will be involved in the settling of disputes that arise under the code.

Presently if a dispute arises under the GATT, a country can, through article 23, ask for a panel to investigate the matter and render a nonbinding decision.

This mechanism is going to be used in each of the varous codes.

The panel will be composed usually of three to five individuals. They will investigate the matter. Moreover, during their investigations, they will be consulting with the disputants and be performing a mediation function at the same time.

Then they will present the facts as to whether the code has been violated and, on occasion, will make a recommendation to the committee as to how the case should be settled.

This report then goes to the committee signatories who then take any action they wish. They can make recommendations and even authorize retaliations. The panel is, however, not binding, it's advisory.

After the panel makes a decision, you have the pressure of public opinion operating to secure compliance with the decision. We have found in the past that the panel system has worked very well and countries usually have complied with the decisions.

One of the difficulties with the panels in the past is that the members of these panels have usually been government officials.

Often they have been officials right there in Geneva working in the GATT. A delegate from one country who is serving on a panel may have to deal the next day with some other matter with delegates from the country he is judging.

If he makes a decision that irritates that particular country, he endangers his own country's economic interests in some other matter.

So some of us have been urging that panel members be individuals who aren't necessarily government people. Maybe they could be ex-government people. However, they must be knowledgeable about GATT matters and understand the fragility of the organization.

Although the codes now state that both government and nongovernment people can be panel members, one of the main codes does say that preference will be given to government individuals. I would like to see that loosened up a bit.

Another aspect of the existing dispute settlement mechanism that some of the smaller countries have complained about is that the big countries have exerted unfair pressures on delegates who are panel members to come out with a favorable decision on their side.

Some of the small developing countries and small industrial countries complain about the brute strength of some of the big countries, countries like the United States and members of the European Community.

So they want to have a system that they feel is more impartial and unbiased. The way it is now set up provides this potential. If we play it straight and get impartial, fair-minded people involved so that they gain the respect of other countries, and all countries begin to see that the decisions aren't going to destroy their economies but are based on good sense, then we can make the codes work for the good of all.

It's not automatic, however. It requires hard work, and pressure by the Congress on the Administration to get good people in the trade field.

Senator STEVENSON. Do you agree about potential?

Dr. CLINE. Yes, I agree with that.

Senator STEVENSON. That is what it boils down to.

Thank you, gentlemen. That is very helpful. We appreciate your testimony.

The committee is adjourned.

[Whereupon, at 11 a.m., the committee was adjourned.]

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